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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1962

No. 305

A. J. WHIPPLE, ET AL., PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 7, 1962
CERTIORARI GRANTED OCTOBER 22, 1962

SUPREME COURT OF THE UNITED STATES

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COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

INDEX

	Original	Print
Proceedings in the United States Court of Appeals for the Fifth Circuit		
Caption (omitted in printing)	A	1
Proceedings before the Tax Court of the United States		
Orders extending time for preparation of evidence, transmission and delivery of record	1	1
Docket entries	3	2
Petition	6	4
Exhibit "A"—Letter—notice of tax deficiency and statement attached thereto	19	14
Answer	29	23
Memorandum findings of fact and opinion	31	24
Decision	45	34
Petition for review and assignments of error	46	35
Notice of filing petition for review	53	40
Stipulation of facts	54	41
Transcript of hearing, April 21 and 22, 1959	63	48
Appearances	63	48
Opening statement on behalf of petitioner by Mr. Schleider	64	49

RECORD PRESS, PRINTERS, NEW YORK, N. Y., DECEMBER 7, 1962

	Original	Print
Proceedings before the Tax Court of the United States—Continued		
Transcript of hearing, April 21 and 22, 1959—Continued		
Opening statement on behalf of respondent by Mr. Bergeron	71	53
Testimony of C. L. Barnhart—		
direct	74	55
cross	79	59
redirect	81	60
Stipulations between petitioner and respondent	82	61
Testimony of Alex W. Head—		
direct	86	64
Edwin C. Daniels—		
direct	96	70
cross	106	78
redirect	112	82
recross	113	83
A. J. Whipple—		
direct	115	84
cross	161	121
redirect	169	127
Motion for transmission of testimony, stipulation of facts and original exhibits, and order thereon	175	130
Praecipe for record	177	131
Clerk's certificate (omitted in printing)	180	132
Minute entry of argument and submission	181	132
Opinion, Tuttle, J.	182	133
Dissenting opinion, Hutcheson, J.	189	138
Judgment	196	144
Petition for rehearing	197	144
Order denying petition for rehearing	201	148
Motion for stay of mandate	202	148
Order staying mandate	205	150
Clerk's certificate (omitted in printing)	206	150
Order allowing certiorari	207	151

	Original	Print
Petitioners' exhibits:		
No. 13-M—Joint U. S. individual income tax return of A. J. Whipple and Mildred Whipple for calendar year 1952	208	153
No. 20-T—Joint U. S. individual income tax return of A. J. and Mildred Whipple for calendar year 1953	229	174
No. 21—Work sheets showing advances made by petitioner to Mission Orange Bottling Co. and the disposition of such advances by Mission Orange Bottling Co.	238	183

[fol. A] [Caption omitted]

[fol. B] [File endorsement omitted]

Transcript of Record—Filed June 12, 1961

[fol. 1]

BEFORE THE

TAX COURT OF THE UNITED STATES

Docket No. 65603

A. J. WHIPPLE and MILDRED WHIPPLE,
Petitioners on Review,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

ORDER EXTENDING TIME—February 24, 1961

For cause, it is

Ordered: That the time for preparation of the evidence, transmission and delivery of the record on review in the United States Court of Appeals for the Fifth Circuit is extended to May 5, 1961.

J. E. Murdock, Judge.

[fol. 2]

BEFORE THE TAX COURT OF THE UNITED STATES

[Title omitted]

ORDER EXTENDING TIME—December 20, 1960

For cause, it is

Ordered: That the time for preparation of the evidence, transmission and delivery of the record on review in the United States Court of Appeals for the Fifth Circuit is extended to March 6, 1961.

J. E. Murdock, Judge.

[fol. 3]

BEFORE THE TAX COURT OF THE UNITED STATES

[Title omitted]

ORDER EXTENDING TIME—November 1, 1960

For cause, it is

Ordered: That the time for preparation of the evidence, transmission and delivery of the record on review in the United States Court of Appeals for the Fifth Circuit is extended to January 5, 1961.

J. E. Murdock, Judge.

BEFORE THE TAX COURT OF THE UNITED STATES

[Title omitted]

DOCKET ENTRIES

Appearances:

For Petitioners: Charles Dillingham, Esq., Ben H. Schleider, Jr., Esq.

For Respondent:

1957

Jan. 22—Petition received and filed. Taxpayer notified. Fee paid.

[fol. 4]

Jan. 28—Copy of petition served on General Counsel.

Jan. 22—Notice of appearance of Charles Dillingham as counsel filed. Served 1/28/57.

Jan. 22—Request for Circuit hearing in Houston, Texas filed by petrs. 1/25/57, granted. Served 1/28/57.

Mar. 11—Answer filed by resp. Served 3/13/57.

1959

Jan. 27—Notice of trial at Galveston, Texas. Apr. 20, 1959. Served 1/27/59.

Apr. 21, 22—Trial at Galveston by Judge Opper. Stip. of facts and exhibits filed. Appearance of Ben H. Schleider, Jr., Esq. Orig. briefs due July 21, 1959; replies due Sept. 4, 1959.

May 15—Transcript of proceedings of April 21, 22, 1959 filed.

July 20—Brief for petr. filed.)

July 21—Brief for resp. filed.) Served 7/22/59.

Sept. 3—Reply brief filed by petr. Served 9/17/59.

1960

Feb. 29—Memo. findings of fact and opinion filed. Judge Opper. Decision under R. 50. Served 3/1/60.

May 4—Rule 50 Computation filed by Respondent.

May 6—Notice of hearing June 8, 1960, Washington, D.C. on R. 50 Computation. (Resp.) Served 5/6/60.

June 8—Hearing at Washington, D.C. on Rule 50 Computation. Decision to entered in accordance to Resp. Comp.

June 9—Transcript of proceedings of June 8, 1960.

June 13—Decision entered, Judge Opper. Served 6/14/60.

Aug. 16—Order fixing bond at $28,000.00. Served 8/16/60.

Sept. 7—Surety bond in the amount of $28,000.00 approved and filed.

[fol. 5]

1960

Sept. 7—Petition for review by U. S. Ct. of Ap. 5th Cir. with assignments of error filed by petrs.

Sept. 7—Proof of service filed by petrs.

Oct. 10—Certified copy of order of U.S.C.A. 5th Cir. directing inclusion in the transcript of record in lieu of a narrative statement of the evidence of the original official report of proceedings before the Tax Court at Galveston, Texas, on 4/21/59 and 4/22/59, and the original stipulation of facts, with original exhibits 1-A thru 20-T, attached thereto, and the originals of petrs' exs. 21 thru 24. All said original exhibits to be transmitted to the appellate Court ten days prior to hearing, filed.

Nov. 1—Order extending time for preparation of the evidence, transmission and delivery of the record on rev. to Jan. 5, 1961. Served 11/1/60.

Dec. 20—Order extending time for preparation of the evidence, transmission and delivery of the record on rev. to Mar. 6, 1961. Served 12/21/60.

1961

Feb. 17—Praecipe for record with proof of service thereon filed by petrs.

Feb. 24—Order extending time for preparation of the evidence, transmission and delivery of the record on rev. to May 5, 1961. Served 2/24/61.

[fol. 6]

BEFORE THE TAX COURT OF THE UNITED STATES

PETITION—Filed January 22, 1957

A. J. Whipple and Mildred Whipple, the above named Petitioners, hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency ARC:AP:DAL HOU:SED: 90D dated October 22, 1956, and as a basis of his proceedings alleges as follows:

I.

The Petitioners are individuals with their principal residence at 4015 Fernwood Street, Houston, Texas. A

joint return of husband and wife for the period here involved was filed with the Collector of Internal Revenue in Austin, Texas.

II.

The notice of deficiency (copy of which is attached and marked Exhibit "A") was mailed to Petitioners October 22, 1956.

III.

The deficiencies as determined by the Commissioner are in income taxes for the taxable year ended December 31, 1953, in an amount of $17,625.78, and penalties aggregating $2,379.83, and for the taxable year ending December 31, 1952, in an amount of $297.04.

[fol. 7] IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors

A. The Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by disallowing as a deduction dues expense in the amount of $347.00 on the basis that it was a personal expense, when actually these dues were incurred as business expenses.

B. The Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by disallowing as a deduction the commission expenses paid to D. M. Dozier and R. F. Jordan, and including them as costs of land, since these payments were made for personal services, and are therefore a proper deduction from Petitioners' ordinary income.

C. The Commissioner erred in assessing a deficiency against Petitioners for the Calendar year 1953 by disallowing the deduction of $56,975.10 bad debt of Mission Orange Bottling Company of Lubbock, Inc., from ordinary income as a business bad debt and classifying it as a capital loss, or in the alternative the deduction as an ordinary business loss of $33,577.33 of such $56,975.10 bad debt which had

been guaranteed by Petitioner, A. J. Whipple, personally, when Mission Orange Bottling Company of Lubbock, Inc., was solvent, and which Petitioner A. J. Whipple had been forced to pay under his guaranty when the corporation was hopelessly insolvent.

D. The Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by disallow-
[fol. 8] ing as a long term capital loss $2,500.00 as the cost of Texas International Manganese stock which became worthless in the year 1953.

E. The Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by assessing a penalty in the amount of $1,326.54 under Section 294(d)(1)(A) I.R.C.1939 representing maximum penalties for each quarter based on the actual tax which ultimately became due, although the actual amount of such tax could not be determined until after December 31, 1954, and was not required to be determined until March 15, 1954.

F. The Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by assessing a penalty in the amount of $804.00 under Section 294(d)(1)(B) representing maximum penalties for each quarter based on the actual tax which ultimately became due, although the actual amount of such tax could not be determined until after December 31, 1954, and was not required to be determined until March 15, 1954.

G. The Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1952 by assessing a penalty in the amount of $2,664.07 under Section 294(d)(1)(B) representing maximum penalties for each quarter based on the actual tax which ultimately became due, although the actual amount of such tax could be determined until after December 31, 1953, and was not required to be determined until March 15, 1953.

H. The Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1952 by assess-
[fol. 9] ing a penalty in the amount of $1,776.04 and under Section 294(d)(2). I.R.C. 1939 representing maximum pen-

alties for each quarter based on the actual tax which ultimately became due, although the amount of such tax could not be determined until after December 31, 1953, and was not required to be determined until March 15, 1953.

V.

The facts upon which Petitioners rely as a basis of this proceeding are as follows:

A. During the year 1953 and for several years prior thereto Petitioner A. J. Whipple was in the lumber, construction, restaurant, and bottling business and the dues which have been disallowed were paid in connection with organizations which the Petitioner had originally joined and continued as a member primarily for promotional and business purposes, and hence were proper miscellaneous business deductions.

B. The commissions paid to D. M. Dozier and R. F. Jordan were paid by Petitioner A. J. Whipple as compensation for their personal services and are therefore a proper deduction as such from Petitioners' ordinary income.

C. A. J. Whipple purchased the Mission Orange Bottling equipment and inventory of the Mission Orange Bottling plant in Lubbock, April 28, 1951, from D. C. Casey and assumed the lease to the premises at 2518 Avenue H, Lubbock, Texas. The franchise of Mission Orange Bottling Company was transferred to Petitioner A. J. Whipple individually and has been retained in his name individually to date. Mr. Whipple operated this plant for several [fol. 10] months as an individual, but in June, 1951, because of the fear of personal liability from products being sold and to allow a few friends and associates to invest in a part of the business, organized Mission Orange Bottling Company of Lubbock, Inc., for the purpose of limiting liability. Mr. Whipple himself later personally operated a machine vendor operation selling Mission Orange bottling products through vending machines as a joint venture on the side with two employees of the corporation.

During the first half of 1951, Mr. Whipple had liquidated his interest which he held in 13 corporations of which he

had been an organizer and 3 partnerships in the lumber, construction and real estate development fields, all of which had been highly successful. This liquidation had been the result of Mr. Whipple's severing his association in these former enterprises with Miles Strickland and John Anderson and his going into business for himself in a variety of enterprises consisting of a lumber company, an equipment company, four building and development companies, a restaurant, formation of a club corporation over the restaurant and bottling business in Lubbock. In the case of the lumber company, the restaurant, and the club, as well as the bottling plant, the premises are leased from Mr. Whipple. Mr. Whipple deliberately chose the restaurant and bottling businesses for the purpose of diversification. Throughout the five or six years which Mr. Whipple with Mr. Strickland, and sometimes Mr. Anderson, had been engaged in joint enterprises together, it had been their practice to form corporations with small capitalization and lend them money for operating capital until the corporations were able to accumulate enough in earnings to provide their own necessary operating capital. Then such sums previously ad- [fol. 11] vanced would be repaid from the corporation and used to finance additional enterprises. Virtually all the 13 corporations referred to above had been formed and financed this way and during 1951 and the next few years the corporations which he formed and controlled individually continued this practice.

Mission Orange Bottling Company of Lubbock, Inc., was capitalized and financed much along the same formula which Mr. Whipple had used in the numerous other enterprises in which he had had an interest. It was incorporated for $20,000 of stock issued to Mr. Whipple and certain associates, a portion of which was used in June, 1951, to purchase some of the physical assets of the business being operated by Mr. Whipple personally. The balance of the purchase of the equipment was set up on the corporation books as an account payable to Mr. Whipple. Credit from a Lubbock bank and from the suppliers of bottles, syrups and other materials necessary in the operation had been extended to Mr. Whipple personally. Although these obligations were assumed by the corporation

after it was formed, the bank, suppliers and other creditors required the personal indorsement and guarantee of Mr. Whipple in connection with almost all credit transactions of the corporation thereafter. It was expected that with this financial backing by Mr. Whipple personally the business would enjoy a substantial profit during the Summer months but the season proved to be something of a disappointment and it was decided that a new plant with expanded and up-to-date equipment would be necessary and desirable for the business. By this time the retail prices of soft drinks in many of the surrounding territories had been increased and it was expected that a price increase in the Lubbock area would be forthcoming shortly and thus raise [fol. 12] the profit margin of the business substantially. On the basis of these factors, Mr. Whipple personally constructed a large up-to-date modern plant and leased it to the corporation to operate.

Unfortunately, the new plant did not result in as much increased production as anticipated and the hoped for price increase did not occur. During the year 1953 the corporation lost more and more money and by December 1953 was completely insolvent without enough assets to pay off its obligations. By that time the corporation owed Mr. Whipple $120,447.86 and outside creditors approximately $80,000.00. About the only assets of the corporation which were worth anything were the plant equipment. Therefore, on December 15, 1953, Mr. Whipple entered into an agreement with the corporation under which he took the plant equipment and credited the corporation with its approximate book value of $70,000.00 at the same time he paid into the corporation $48,000, which was enough to pay off all other current obligations.

After the equipment had been taken out of the corporation on December 15, 1953, the corporation had virtually no assets out of which his balance of $56,975.10 could be paid, and this bad debt thereby became worthless. The only hope then of salvaging anything was to be able to sell the plant and equipment, which he has tried unsuccessfully since that time to do. When this bad debt became worthless, therefore, Mr. Whipple was the owner of the building and all of the physical equipment of the plant

and was actually managing the plant. Mr. Finley, a Vice President and Manager, had resigned during the Summer, leaving the plant with no manager. Actually, all important policy decisions and all details of finance and purchases had [fol. 13] been determined by Mr. Whipple throughout the whole period of the operation of the business in Lubbock as is best shown by the fact that during this two-year period Mr. Whipple made 273 long distance calls to Lubbock and 62 long distance calls were made from the plant to Mr. Whipple. Furthermore, Mr. Whipple had made 35 trips to Lubbock and the Manager and Plant Superintendent had made 14 trips to Houston, all in connection with the Lubbock Mission Orange operation.

From all of the foregoing facts it is respectfully submitted that Mr. Whipple was in the business of forming and financing corporations and was engaged in the business of acquiring, owning, financing, equipping and leasing a plant for the operation of the bottling business and was actually throughout this period engaged in the overall enterprise of owning and operating a bottling plant in Lubbock and that a business bad debt loss should be sustained.

In the alternative, but not by way of admission, even though the $56,975.10 bad debt was not a business bad debt, $33,577.33 should be allowed as an ordinary business loss by virtue of the following payments made in 1953 by Petitioner, A. J. Whipple, as personal guarantor of Mission Orange Bottling Company of Lubbock, Inc., indebtedness:

7/28/53	First National Bank in Lubbock	$ 1,005.14
8/ 4/53	Owens Illinois Glass	1,582.42
12/16/53	First National Bank in Lubbock	18,996.42
12/15/53	Parker Brown (oral)	2,421.40
12/15/53	Casey Delaney Insurance	820.38
12/15/53	Canada Dry	2,085.47
12/15/53	Knox Glass (He thinks)	600.00
[fol. 14]		
12/15/53	Federal Sign Co.	195.00
12/15/53	Owens Illinois Glass	2,931.48
12/15/53	Liberty Glass	2,939.62
		$33,577.33

When certain of the assets of the bottling business were transferred by Petitioner A. J. Whipple in June 1951 to Mission Orange Bottling Company, Inc., for part of the bottling enterprise to be conducted through the corporation, it was necessary in order to obtain adequate credit and operating capital to carry on the operations for A. J. Whipple personally to guarantee personally many of the accounts and obligations of the corporation. This situation continued throughout 1951 and 1952 and part of 1953, when it still appeared that the corporation was going to make money later. During 1953 the corporation began to be insolvent and it was unable to pay off its debts out of its own funds and A. J. Whipple was called upon by those creditors to whom he had made personal guarantees of the corporation's debts to pay off those accounts personally, as set forth above. It is respectfully submitted that under the circumstances Petitioners were entitled to deduct such sums totaling the $33,577.33 as an ordinary business loss.

D. The cost of Texas International Manganese stock was $2500.00, and the stock became completely worthless in the calendar year 1953.

E. During the year 1953 Petitioner, A. J. Whipple, was engaged in the building, bottling and restaurant business, all of which were very speculative, and the extent of his income and losses in such business was impossible to estimate or determine until after December [fol. 15] 31, 1953, and not until complicated accounting work was done, which was not finished until February or early March 1954.

F. During the year 1953 Petitioner, A. J. Whipple, was engaged in the building, bottling and restaurant business, all of which were very speculative, and the extent of his income and losses in such business was impossible to estimate or determine until after December 31, 1953, and not until complicated accounting work was done, which was not finished until February or early March 1954.

G. During the year 1952 Petitioner, A. J. Whipple, was engaged in the building, bottling and restaurant business, all of which were very speculative, and the extent of his income and losses in such business was impossible to estimate or determine until after December 31, 1952, and not until complicated accounting work was done, which was not finished until February or early March, 1953.

H. During the year 1952 Petitioner, A. J. Whipple, was engaged in the building, bottling and restaurant business, all of which were very speculative, and the extent of his income and losses in such business was impossible to estimate or determine until after December 31, 1952, and not until complicated accounting work was done, which was not finished until February or early March, 1953.

Wherefore, Petitioners pray that this Court hear the proceeding and then:

A. Determine that the Commissioner erred in assessing a deficiency against Petitioners for the calendar year [fol. 16] 1953 by disallowing as a deduction dues expense in the amount of $347.00; and

B. Determine that the Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by disallowing as a deduction the expenses paid to D. M. Dozier and R. F. Jordan as commissions; and

C. (1) Determine that the Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by disallowing the deduction of $56,975.10 as a business bad debt loss of amounts owed Petitioners by Mission Orange Bottling Company of Lubbock, Inc.; or

(2) In the alternative that the Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by disallowing the deduction as an ordinary business loss of $33,577.33 of the Mission Orange Bottling Company of Lubbock, Inc.'s $56,975.10 bad debt; and

D. Determine that the Commissioner erred in assessing a deficiency against Petitioners for the calendar year 1953 by disallowing as a long term capital loss $2500.00

as the cost of Texas International Manganese stock, which became worthless in the year 1953.

E. Determine that the Commissioner has erred in assessing a penalty against Petitioners for the calendar year 1953 under Section 294(d)(1)(A) I.R.C. 1939 in the amount of $1,326.54.

F. Determine that the Commissioner has erred in assessing a penalty against Petitioners for the calendar year 1953 [fol. 17] under Section 294(d)(1)(B) in the amount of $804.00.

G. Determine that the Commissioner has erred in assessing a penalty against Petitioners for the calendar year 1952 under Section 294(d)(2) I.R.C. 1939 in the amount of $2,664.07.

H. Determine that the Commissioner has erred in assessing a penalty against Petitioners for the calendar year 1952 under Section 294(d)(2) I.R.C. 1939 in the amount of $1776.04.

A. J. Whipple, Mildred Whipple.

Duly sworn to by A. J. Whipple, jurat omitted in printing.

[fol. 18] *Duly sworn to by Mildred Whipple, jurat omitted in printing.*

Dillingham & Schleider, Charles Dillingham, Attorneys for Petitioners.

802 Texas National Bank Bldg., Houston 2, Texas.

[fol. 19]

EXHIBIT "A" TO PETITION

Appellate Division
316 Federal Land Bank Building
430 Lamar Avenue
Houston 2, Texas
Oct. 22, 1956

Registered

ARC:AP:DAL
HOU:SED:90D

Mr. A. J. Whipple and
Mrs. Mildred Whipple
Husband and Wife
4015 Fernwood Drive
Houston, Texas

Dear Mr. and Mrs. Whipple:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1952 and December 31, 1953, discloses deficiencies in tax aggregating $17,922.82 and penalties aggregating $6,818.94, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D.C., for a redetermination of the deficiency or deficiencies. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Satur-
[fol. 20] days, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to

the Associate Chief, Appellate Division, 316 Federal Land Bank Building, 430 Lamar Avenue, Houston 2, Texas. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earliest.

Very truly yours,

RUSSELL C. HARRINGTON
Commissioner
By (Signed) ROLAND K. JONES, RWC
Associate Chief, Appellate Division.

Enclosures:

Statement.
Form 1276.

[fol. 21]

ATTACHMENT TO EXHIBIT "A"

Statement.

ARC:AP:DAL
HOU:SED:90D

Mr. A. J. Whipple and Mrs. Mildred Whipple Husband and Wife
4015 Fernwood Drive
Houston, Texas

Summary of Income Tax Liability.

Year	Deficiency	Penalties Internal Revenue Code (1939) Sec. 294 (d)(1)(A)	Sec. 294 (d)(1)(B)	Sec. 294 (d)(2)
1952	$ 297.04	$2,664.07	$ —	$1,776.04
1953	17,625.78	1,326.54	804.00	248.29
Totals	$17,922.82	$3,990.61	$804.00	$2,024.33

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated June 1, 1955; to your protest dated October 15, 1955; and to the statements made at the conferences held on February 9, 1956 and May 18, 1956.

Since you did not file timely declarations of estimated tax for the years 1952 and 1953 the penalty provided in section 294(d)(1)(A) of the Internal Revenue Code of 1939 is being asserted to such years as reflected herein.

Inasmuch as 80 percent of your final tax for each of the taxable years 1952 and 1953 is in excess of any estimated tax declared for such years the penalty provided in sec- [fol. 22] tion 294(d)(2) of the Internal Revenue Code of 1939 is being asserted to such years as reflected herein.

A penalty in the amount of $804.00 has been imposed as to the year 1953 under the provisions of section 294 (d)(1)(B) of the Internal Revenue Code of 1939 inasmuch as you failed to pay an installment of the estimated tax declared by you for such year within the time prescribed.

A copy of this letter and statement has been mailed to your representative, Mr. Charles Diflingham, 802 Texas National Bank Building, Houston 2, Texas, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

Taxable year ended Dec. 31, 1952.

Scnedule 1.

Adjustments to Net Income.

Net income shown on joint return		$67,694.28
Additional income and unallowable deductions:		
(a) Interest income	$ 22.00	
(b) Miscellaneous expense	67.80	
(c) Dues expense	347.00	
Total	$436.80	
Net income as adjusted		$68,131.08

Schedule 1-A.

Explanation of Adjustments.

(a) The deduction for interest in the amount of $22.00 shown in your return as accrued and unpaid is disallowed [fol. 23] since it was not treated as an accrual of the taxable year.

(b) Under miscellaneous expense you claimed a deduction for a penalty paid in connection with unemployment taxes in the amount of $67.80. This deduction is disallowed since penalties are not considered ordinary and necessary business expense.

(c) Dues expense

7-28-52 YMCA Membership	$100.00
8-31-52 Houston Turnverien	36.00
9- 9-52 Golferest Country Club	24.00
10- 8-52 Golferest Country Club	24.00
11-10-52 Golferest Country Club	24.00
11-10-52 Wm. Pierson	12.00
12- 9-52 Golferest Country Club	27.00
7-25-52 Sam Alexander	100.00
Total	$347.00

It has been determined that the above-listed amounts of dues, membership, and miscellaneous items constitute personal expenses and they are accordingly disallowed as deductible business expenses.

Schedule 2.

Computation of Tax.

Net income as adjusted	$68,131.08
Exemptions	2,400.00
Income subject to tax	$65,731.08
One-half of such income	32,865.54
Tax on $32,865.54	$16,604.57

[fol. 24] Multiply by 2 for tax liability $33,209.14
Liability shown on return, Acct. No. AP. 700400 .. 32,912.10

Deficiency ..... $ 297.04

Penalty for failure to file declaration of estimated tax on time:

Liability $33,209.14
Amount withheld on wages 3,608.40

Balance to be divided into 4 installments $29,600.74

Due Date	Amount due	Amount paid	Not timely paid	Months unpaid	Percentage	Penalty
3/15/52	$7,400.10	$None	$7,400.19	12	10%	$ 740.02
6/15/52	7,400.19	None	7,400.19	9	10%	740.02
9/15/52	7,400.18	None	7,400.18	6	10%	740.02
1/15/53	7,400.18	None	7,400.18	2	6%	444.01

Penalty, Section 294 (d)(1)(A), I.R.C. 1939 $2,664.07

Penalty for substantial underestimate:

Liability $33,209.14
Amount withheld on wages 3,608.40

Underestimate $29,600.74
Penalty, Sec. 294(d)(2), I.R.C. 1939, 6% of $29,600.74 ..... $ 1,776.04

Taxable year ended December 31, 1953.

Schedule 3.

Adjustments to Net Income

Net income shown on joint return $12,805.50

[fol. 25] Additional income and unallowable deductions:

(a) Worthless lease loss	63.39
(b) Dues expense	145.00
(c) Commissions expense	5,349.50
(d) Bad debt	56,975.10
Total	$62,532.99

Nontaxable income and additional deductions:		
(e) Long-term capital gain	$25,690.99	
(f) Short-term capital loss	1,000.00	
Total	$26,690.99	
Net addition		35,842.00
Net income as adjusted		$48,647.50

Taxable year ended December 31, 1953.

Schedule 3-A.

Explanation of Adjustments.

(a) You claimed a deduction in the amount of $250.00 on account of a worthless oil lease. Of the total claimed the sum of $186.61 was substantiated leaving a balance of $63.39 which is disallowed.

(b) The explanation for this adjustment is the same as that shown in schedule 1-A (c).

The items disallowed are:

1-22-53	Golferest Country Club	$ 24.00
2-12-53	Golferest Country Club	24.00
2- 6-53	Houston Turnverien	36.00
5-14-53	Arabia Temple Drum Corps	25.00
11-14-53	Scottish Rite	12.00
11-14-53	Golferest Country Club	24.00
	Total	$145.00

[fol. 26] (c) Commission expense claimed in your return for the taxable year in the amount of $5,349.50 is disallowed as an ordinary and necessary business expense. It has been determined that such amount, consisting of a payment of $2,000.00 to R. F. Jordan and $3,349.50 to D. M. Dozier, constitutes part of the cost of acquiring land. Inasmuch as this land was acquired in 1952 and sold during 1953 the said amount of $5,349.50 has been added to the basis of such property in computing the long-term capital gain from its sale elsewhere in this statement.

(d) In your return for the taxable year you claimed a deduction for a business bad debt in the amount of $56,975.10, representing an amount claimed to be due you from Mission Orange Bottling Company of Lubbock, Inc., Lubbock, Texas. It has been determined that such amount constitutes a non-business bad debt within the concept of section 23(k)(4) of the Internal Revenue Code of 1939. As such it has been disallowed as an ordinary business bad debt deduction and has been treated elsewhere in this statement as a short-term capital loss.

(e) The long-term capital gain of $25,690.99 reported by you is eliminated and the capital gains and losses are recomputed as follows:

Short-term capital loss (non-business bad debt)			$56,975.10
Long-term capital gain, per return, 100%		$51,381.99	
Add: Loss based upon the worthlessness of Texas Manganese Steel Stock disallowed	$2,500.00		
[fol. 27] Deduct: Commission expense allowed as additional cost of property sold	5,349.50	2,849.50	
Long-term capital gain as adjusted		$48,532.49	
Less: Long-term capital loss, stock of Mission Orange Bottling Co.		31,800.00	
Net long-term capital gain			16,732.49
Net short-term capital loss (brought forward)			$40,242.61
Less: Amount allowed, 1953			1,000.00
Capital loss carry-over			$39,242.61

In computing net long-term capital gain in the foregoing schedule no loss has been allowed to you arising from worthlessness of the stock Texas International Manganese Company. It has been determined that no such loss is allowable inasmuch as you have failed to substantiate any cost basis in such stock or the fact of its becoming worthless during the taxable year.

(f) You are allowed the maximum capital loss deduction in the taxable year.

Schedule 4.

Computation of Tax.

Net income as adjusted	$48,647.50
Exemptions	2,400.00
[fol. 28] Income subject to tax	$46,247.50
One-half of such income	$23,123.75
Tax on $23,123.75	$10,097.68
Multiply by 2 for tax liability	$20,195.36
Liability shown on return, Acct. No. BC 1001383	2,569.58
Deficiency	$17,625.78

Penalty for failure to file declaration of estimated tax on time:

Liability	$20,195.36
Amount withheld on wages	2,508.00
Balance to be divided into 4 installments	$17,687.36

Due Date	Amount due	Amount paid	Not timely paid	Months unpaid	Percentage	Penalty
3/15/53	$4,421.84	$None	$4,421.84	12	10%	$ 442.18
6/15/53	4,421.84	None	4,421.84	9	10%	442.18
5/15/53	4,421.84	None	4,421.84	6	10%	442.18
1/15/54	—	—	—	—	—	—

Penalty, Section 294(d)(1)(A), I.R.C. 1939	$1,326.54

Penalty for failure to pay installments on estimated tax:

*Estimated tax shown on Form 1040-ES $13,400

Due Date	Amount due	Amount paid	Not timely paid	Months unpaid	Percentage	Penalty
3/15/53	—	—	—	—	—	—
6/15/53	—	—	—	—	—	—
9/15/53	—	—	—	—	—	—
1/15/54	$13,400.00	$None	$13,400.00	2	6%	$804.00

Penalty, Section 294(d)(1)(B), I.R.C. 1939 $804.00

[fol. 29] Penalty for substantial underestimate of estimated tax, Section 294(d)(2), Internal Revenue Code 1939:

Liability		$20,195.36
80% of above amount		$16,156.29
Less: Amount withheld on wages	$ 2,508.00	
Estimated tax	13,400.00	15,908.00
(a) Tentative addition to tax		$ 248.29
Liability		$20,195.36
Less: Amount withheld on wages	$ 2,508.00	
Estimated tax	13,400.00	15,908.00
Difference		$ 4,287.36
(b) Tentative addition to tax, 6% of $4,287.36		$ 257.24

Penalty
Item (a) or (b), whichever is lesser $ 248.29

* Declaration of estimated tax filed January 15, 1954.

BEFORE THE TAX COURT OF THE UNITED STATES

ANSWER—Filed March 11, 1957

The Respondent, in answer to the petition filed in this case admits and denies as follows:

I., II.

Admits the allegations of paragraphs I and II of the petition.

[fol. 30]

III.

Admits that the deficiencies as determined by the Commissioner are in income taxes for the taxable year ended December 31, 1953, in an amount of $17,625.78, and penalties aggregating $2,378.83, and that there were deficiencies and penalties determined for the taxable year ending December 31, 1952; but denies the remaining allegations of paragraph III of the petition.

IV.

A. through H. Denies that the respondent erred in the manner alleged in paragraphs IV.A through IV.H, inclusive of the petition.

V.

A. and B. Denies the allegations of paragraphs V.A and V.B of the petition.

C. and D. Denies the allegations of paragraphs V.C and V.D of the petition for want of information sufficient to form a belief.

E. through H. Denies the allegations of paragraphs V.E through V.H, inclusive, of the petition.

VI.

Denies generally each and every allegation of the petition not hereinbefore specifically admitted, qualified or denied.

[fol. 31] Wherefore, it is prayed that the deficiencies determined by the respondent be in all respects approved.

Herman T. Reiling, FSG, Acting Chief Counsel, Internal Revenue Service.

Of Counsel: J. Marvin Kelley, Regional Counsel, Robert L. Liken, Attorney, Internal Revenue Service, 201 Federal Land Bank Building, Houston 2, Texas.

RLL/mfn
2/28/57

BEFORE THE TAX COURT OF THE UNITED STATES

MEMORANDUM FINDINGS OF FACT AND OPINION
—Filed February 29, 1960

T. C. Memo. 1960-36

[Title omitted]

Opper, Judge: Respondent determined deficiencies in petitioners' income tax and in additions to tax for the years 1952 and 1953 as follows:

[fol. 32]

Year	Income Tax	Sec. 294[1] (d)(1)(A)	Sec. 294 (d)(1)(B)	Sec. 294 (d)(2)
1952	$ 297.04	$2,664.07	—0—	$1,776.04
1953	17,625.78	1,326.54	$804.00	248.29

The issues to be decided are (1) whether a $56,975.10 debt owed to petitioners in 1953 which became uncollectible in that year was a business or nonbusiness bad debt within the meaning of section 23 (k), and (2) whether $3,349.50, paid by petitioners in 1953 to D. M. Dozier, is a deductible business expense or a capital expenditure. Petitioners abandoned, on brief, all alleged errors in regard to the imposition of additions to tax under section 294(d), except as to the correct amount of additions to tax due for 1953

[1] All section references are to the Internal Revenue Code of 1939.

under section 294 (d)(1)(A) which may be resolved in accordance with Rule 50 after we dispose of the major issues presented for our decision. Other issues raised by the pleadings have either been conceded or resolved by stipulation.

Findings of Fact

The stipulated facts are found.

A. J. Whipple, hereafter called petitioner, and Mildred Whipple are husband and wife and reside in Houston, Texas. They filed their joint income tax returns for 1952 and 1953 with the district director of internal revenue at Austin, Texas.

Petitioner, prior to 1941, was a construction superintendent and an estimator for a lumber company. In 1941, and for about a year thereafter, he and W. E. Brown were partners in the construction of houses and homes.

[fol. 33] Around 1942 petitioner, Miles Strickland and W. C. Perkins formed the S.W.P. Construction Company, a partnership organized to build houses. Perkins later withdrew from this venture and the partnership became known as S. & W. Construction Company. At some time subsequent to 1942, petitioner and Strickland formed the following partnerships: Evergreen-Rice Company, a construction company; Airline Lumber and Supply Company, Ltd., of which John W. Anderson was also a partner; Shakertown Distributors, formed, with Anderson, to distribute shingles; Gulf Coast Plumbing and Supply Company; and State Tile Distributors, a wholesale tile company which resulted from petitioner's informal negotiations to purchase 4 carloads of tile.

During the years 1949 and 1950, petitioner was an original incorporator of 7 corporations, as follows: Federal Road Building Corporation; Richmond Plaza, Inc.; Strickland-Whipple Construction Company, Inc., a successor to the partnership S. & W. Construction Company; Airline Lumber and Supply Company, Inc., a successor to the partnership, Airline Lumber and Supply Company, Ltd.; Dorwayne Construction Corporation; 29th and Airline, Inc., a real estate rental corporation which owned and rented the property occupied by Airline Lumber and Sup-

ply Company, Inc., and Shakertown Distributors; and Federal Road Lumber Company, Inc.

In 1951 petitioner sold his interest in the 7 above-named corporations and in Shakertown Distributors to Miles Strickland. During the same year he sold to Strickland his equity in 5 other corporations. In his 1951 income tax return, petitioner reported this sale as relating to property he acquired in 1949. These 5 corporations, namely, Industrial Homes, Inc., Harbor Homes, Inc., Commonwealth and California Corporation, Commonwealth and [fol. 34] Missouri Corporation, and Riverside Apartments Corporation, were in the rental housing or construction business. All of these sales resulted in gain to petitioner which he reported on his 1951 return as long-term capital gain.

In 1951 petitioner purchased the land and improvements located at 2436 Bissonnet Street, Houston, Texas, as the location for various construction businesses and other enterprises. He formed the A. J. Whipple Construction Company, which was a partnership of petitioner, V. L. Yarborough, Leonard Olive and G. A. Durham. This partnership was later succeeded by another partnership, A. J. Whipple Construction Co. No. 2.

During the years 1951 and 1952, petitioner was an original incorporator of 8 corporations, as follows: Whipple Lumber Company; Whipple Equipment Co., Inc., which engaged in the business of renting automobiles, trucks and construction equipment; Dozier-Whipple Construction Corporation; Chevy Chase Development Corporation; Whipple Construction Co., Inc.; Angelton Homes Corporation; Angelton Building & Holding Corp.; and Mission Orange Bottling Co. of Lubbock, Inc., hereafter called Mission Orange. During 1952 and 1953, petitioner received salaries totaling $29,400 and $33,450, respectively, from some of the construction corporations.

Petitioner acquired land in Pasadena, Angelton, Bellaire and Houston, Texas, and engaged in sales activities with respect to such lands during 1951 through 1953. He purchased a restaurant in Houston and sold it to Guy Francis on June 1, 1953. At some time he engaged in several oil ventures.

[fol. 35] On April 17, 1951, petitioner acquired an option to purchase the Mission Orange Bottling Co., a sole proprietorship owned by D. C. Casey. On April 21, 1951, petitioner, as lessee, rented the premises occupied by Casey's business for 20 months, effective May 1, 1951, for $150 per month. On April 25, 1951, petitioner obtained a franchise from the Mission Dry Corporation entitling him to produce, bottle, distribute, and sell Mission beverages in certain counties in Texas. On April 27, 1951, petitioner purchased the bottling machinery and equipment from Casey for $46,225. He conducted this business as a sole proprietorship under the name Mission Orange Bottling Co. until approximately July 1, 1951, when he sold the bottling machinery and equipment to Mission Orange. He did not transfer the franchise to Mission Orange.

Mission Orange was organized under the laws of Texas on June 8, 1951, with an authorized capital stock of $20,000, of which amount $10,000 or 100 shares, par value of $100 each, were subscribed to and paid for by the following persons:

Shareholder	Office Held	Shares	Par Value
Petitioner	President	88	$ 8,800
James A. Finley	Vice President	10	1,000
Charles Dillingham	Secretary	2	200
Total		100	$10,000

[fol. 36] The charter of Mission Orange was amended on December 8, 1952 to increase the authorized capital stock to $40,000. Thereafter the issued and outstanding stock was held as follows:

Shareholder	Shares	Per cent	Par Value
Petitioner	308	77.	$30,800
James A. Finley	10	2.5	1,000
Charles Dillingham	2	.5	200
Cecil Clark	20	5.	2,000
Dora B. Ellzey	10	2.5	1,000
D. M. Dozier	10	2.5	1,000
Jack Knostman	20	5.	2,000
James F. Webster	20	5.	2,000
Total	400	100.	$40,000

Sometime prior to the end of 1953, petitioner increased his holding to 318 shares, which was 79.5 per cent of those outstanding and represented an investment of $31,800.

In 1952 petitioner erected a bottling plant on land which he purchased in Lubbock, Texas. The land and building cost a total of $43,601.70. On July 14, 1952, petitioner leased this plant to Mission Orange for a 10-year term, beginning August 1, 1952, with an option to renew. The prescribed rental was $500 per month for the first 3 years and $500 per month plus 1 per cent of gross sales thereafter. In his 1952 and 1953 return, petitioner claimed a deduction for depreciation of the bottling plant in Lubbock. These returns reflect that petitioner received no rent during either year for that building.

Petitioner, directly or indirectly, made cash advances to Mission Orange of $48,550 in 1952 and $6,750 in 1953. [fol. 37] He paid Mission Orange's expenses amounting to $2,975.76 during the years 1951 through 1953 and received refunds and credits totaling $4,388.50. The balance due to petitioner by Mission Orange on December 1, 1953, including the amount of $25,502.50 owed him as the result of his sale of the bottling assets to the corporation in July 1951, was $79,489.76.

On December 15, 1953, petitioner advanced Mission Orange $48,000 to pay general creditors and on the same date received a transfer from Mission Orange of bottling machinery, equipment and an automobile which had a total book value of $70,414.66. The net amount due by Mission Orange to petitioner on December 31, 1953 was $56,975.10. This debt became worthless in 1953.

On September 1, 1951, petitioner acquired stock of a corporation known as Mason Root Beer. This corporation owned a franchise to bottle and sell Mason root beer in Amarillo, Texas. The root beer was bottled at the Mission Orange plant in Lubbock. Mason Root Beer failed in 1953 and petitioner's return for that year reflects a $3,300 loss on his stock in that corporation and a nonbusiness bad debt due from that corporation of $53.33.

Petitioner had a vending machine arangement with Ideal, Indiana, which sold vending machines to the trade. Mission Orange had no interest in this venture.

Petitioner made loans to his various corporations, partnerships, fellow shareholders and partners throughout the years in issue. His income tax returns for 1951, 1952 and 1953 reflect interest income as follows:

[fol. 38]

Payor	1951	1952	1953
Whipple Lumber Co., Inc.	$ 19.35	$ 868.51	$1,047.38
Dozier-Whipple Construction Corp.	61.42	393.89	—
Whipple Construction Co., Inc.	130.68	5.61	—
Angleton Homes Corp.	391.98	—	—
A. J. Whipple Construction Co.	4.92	44.28	—
Cecil Clark	70.56	45.61	—
D. M. Dozier	70.56	45.61	—
G. A. Durham	86.98	74.33	—
J. A. Finley	64.46	—	—
Whipple Equipment Co., Inc.	591.89	575.51	37.82
Willard Evans	70.56	45.61	—
Dora Ellzey	70.56	45.61	—
L. R. Olive	24.99	4.76	—
Durham-Clark Building Supply Co.	9.24	57.95	—
W. N. Atkins	20.81	*(20.81)	—
Roy J. Pate	1.19	*(1.19)	—
Harland Miller	—	47.00	—
The Brag Club, Inc.	—	53.07	19.16
Guy Francis — Guy's Restaurant	—	—	643.23
Total Interest Income	**$1,680.15	$2,285.35	$1,747.59

* Interest accrued and unpaid in 1951.

** The correct total is $1,690.15.

[fol. 39] Petitioner deducted the debt due from Mission Orange on his 1953 return as a business bad debt. Petitioner was not in the business of organizing, promoting, managing or financing corporations in 1953. He was not in the business of lending money in that year.

In his return for 1953, petitioner deducted $3,349.50 as "commissions" paid to D. M. Dozier. Respondent determined that this payment "constitutes part of the cost of acquiring land * * * in 1952 and sold during 1953 * * *." $3,349.50 was entered on petitioner's records as a part of the costs of the purchase of the Westheimer tract, which petitioner purchased on April 3, 1952 for $583,181.47, and sold in 1953 for $672,282.00. At some later time, $3,349.50 was credited on petitioner's records to the Westheimer tract and charged as a direct expense. Petitioner hired Dozier in 1951, agreeing to pay him a salary, expenses and 15 per cent of profits of all joint ventures, partnerships and individual land deals in which petitioner had an interest, except Whipple Lumber Company. Dozier left petitioner's employ in February 1953 before the sale of the Westheimer tract and was paid approximately $29,000 for his share of profits, both realized and anticipated. The $3,349.50 in dispute was included in the foregoing payment. That amount is 15 per cent of the profits anticipated to be realized from the sale of the Westheimer tract.

Petitioner failed to file a declaration of estimated tax for 1952. It is stipulated that he filed such a declaration for 1953 on January 14, 1954.

[fol. 40]

OPINION

The primary issue here is one that is frequently before this Court. Petitioner, through guarantees or outright loans, advanced substantial sums to a corporation which he controlled. Later developments proved his investment unfortunate and he is here claiming that his uncollectible advances arose out of his trade or business and that he should be permitted to deduct them in full and without regard to the limitations imposed on nonbusiness bad debts by section 23 (k) (4).

Petitioner would have us find a proximate relationship between the loss occasioned by the worthlessness of the debt due from Mission Orange and any one of three businesses in which he alleges he was individually engaged at the time of the loss. He contends that he was in the busi-

ness of organizing, promoting, managing and financing corporations, general financing and lending of money, operating a bottling business, or all three,

Looking first to petitioner's alleged promotional activities, it is apparent that he was instrumental in incorporating 15 corporations over a period of less than 4 years, commencing in 1949. Fourteen of these corporations were engaged in the construction, building or real estate business. Petitioner owned stock in 5 additional construction or real estate corporations and at one time or another was a member of 10 partnerships involved in similar activities. Individually, petitioner was in the construction or real estate business.

What petitioner fails to recognize is the distinction between carrying on one's business through a corporate form, which, of course, requires some organizing and financing, [fol. 41] and the business of dealing in corporations, which may likewise require some financing arrangements. [Holtz v. Commissioner, (C.A. 9) 256 F. 2d 865, 870; affirming T.C. Memo. 1957-106.]

His purpose in forming the 14 corporations was to facilitate his construction or real estate business and not to develop them for sale as going businesses to customers in the course of the business of promoting. H. Beale Rollins, 32 T.C. 604, 615. Petitioner apparently entertained that opinion himself in the year 1951 when in his return for that year he reported the sale of 12 corporations and 1 partnership as the sale of capital assets. See Thomas Reed Vreeland, 31 T.C. 78. The evidence does not show that petitioner's business in 1953 was any different from 1951.

Petitioner invites our attention to his 1951, 1952 and 1953 returns to substantiate his claim that he was in the business of lending money. In 1951 he reported the receipt of $1,680.15 as interest from 16 corporations, partnerships or individuals; $1,200.24 of this sum was interest received from his construction corporations or partnerships. In 1952 he reported the receipt of $2,307.35 as interest from 14 corporations, partnerships or individuals; $1,887.80 of this sum was interest received from his construction corporations or partnerships. In 1953, $1,747.59 was reported as interest received from 4 corporations or individuals and

$1,085.20 of this amount was received from 2 of his construction corporations. Some of the other amounts were trivial, such as $9.24 and $1.19 received from Durham-Clark Building Supply Company and Roy J. Pate, respectively, in 1951, and $4.76 received from L. R. Olive in 1952. It therefore appears that the bulk of petitioner's loans went to corporations and partnerships in which he [fol. 42] had an investment and we cannot find that the purpose of these loans was other than to protect that investment. Such lending activity does not constitute a trade or business. Holtz v. Commissioner, supra.

The remaining loans reflected by petitioner's interest receipts were, to a large extent, made to fellow shareholders and partners. We cannot find that lending activity of this nature constitutes trade or business. However, even if we were to find otherwise, there is no evidence that the advances made to Mission Orange were made as a part of that business. Petitioner received intermittent payments from Mission Orange, admittedly small in amount, but he reflected no amount as having been received as interest and there is no evidence that that corporation agreed or was obligated to pay interest. Without interest petitioner stood to make no profit on the loan, and if there is no prospect of profit there is no trade or business. Thacher v. Lowe, (S.D.N.Y.) 288 F. 994.

Petitioner's contention that he was in the bottling business when the debt in question became worthless is without evidentiary support for two reasons. First, petitioner would have us find that he was in the bottling business from December 15 through December 31, 1953 because he was "the dominant stockholder of Masons Root Beer, a participant in soft drink vending machine business, the President of Mission Orange Bottling Co., Inc., the holder of 79% of its stock, the owner of the building in which the bottling plant was located, the holder of the bottling franchise, the owner of the bottling machinery and equipment, [and] the plant manager." Petitioner's relation to Mason Root Beer and Mission Orange as a shareholder, [fol. 43] officer or employee does not place him in the business in which the corporations were engaged. Burnet v. Clark, 287 U.S. 410. Although it appears that petitioner

had sufficient assets subsequent to December 15, 1953 to engage individually in the bottling business, there is no evidence that he did so, and the mere ownership of these assets does not put him in the bottling business.

The second fault we find with petitioner's contention is that the stipulated date of worthlessness of the debt is the year 1953 and there is nothing in the record which might support petitioner's allegation of a more specific date, that is December 31, 1953. If we were required to find a definite time of worthlessness, we should be inclined to select December 15, 1953, at which time petitioner received the bottling assets from Mission Orange in partial satisfaction of that corporation's obligation. At this point petitioner was not in the bottling business. It may be, moreover, that any debt arising at that time was worthless when acquired.

Even if we assume that the debt became worthless subsequent to December 15 and at a time when petitioner was in the bottling business, petitioner must still show us the proximate relationship between his business and the bad debt loss. Jan G. J. Boissevain, 17 T.C. 325. We have been unable to ascertain any proximate relationship between the debt owed by Mission Orange, a corporation no longer in the bottling business, and petitioner's alleged business of bottling soft drinks, and petitioner has pointed out none. A more realistic description of that payment might be an exchange or purchase of corporate assets.

The bad debt losses in question were not incurred in any trade or business conducted by petitioner. They are nonbusiness bad debts and accordingly are to be treated as [fol. 44] short-term capital losses. Section 23 (k) (4).

The evidence submitted in regard to the second issue is vague and indefinite. Petitioner contends that he paid D. M. Dozier $3,349.50 under a contract of employment. The amount in controversy is claimed to have been but a part of a larger sum paid by check to Dozier. Although the testimony is slight, there is no contrary evidence, and on the strength of petitioner's statements under oath, we accept his version that the payments were ordinary and necessary as compensation for contributing services and not a part of a commission on the purchase of specific property.

The final issue concerns additions to tax relating to declarations of estimated tax. The briefs in this case were filed before the Supreme Court handed down its decision in Commissioner v. Acker, 361 U.S. 87. It was held in that case that the additions to tax under section 294 (d) (2) are not to be applied when no declaration of estimated tax has been filed. Respondent's determination of additions to tax under section 294 (d) (2) for 1952 are accordingly disallowed. For 1953 petitioner did file a declaration of estimated tax, although not until January 14, 1954. Respondent determined that this declaration was untimely and petitioner has offered nothing to indicate the contrary. Nor has petitioner shown that his failure to file a timely declaration was due to reasonable cause and not to willful neglect. The addition to tax determined for 1953 under section 294 (d) (1) (A) is therefore upheld. A declaration having been filed for 1953, Commissioner v. Acker, supra, has no application to the addition to tax determined under section 294 (d) (2) for that year, and this determination is also upheld. Rose S. Harkins, 33 T.C. —— (Nov. 30, 1959). Section 294 (d) [fol. 45] (1) (B) imposes an addition to tax for failure to pay installments of estimated tax when either a timely declaration was filed or a declaration was late due to reasonable cause and not to willful neglect. Respondent may not impose additions to tax under both section 294 (d) (1) (A) and section 294 (d) (1) (B). Regs. 118, sec. 39.294-1 (b) (2). The addition to tax determined for 1953 under section 294 (d) (1) (B) is accordingly disallowed.

Decision will be entered under Rule 50.

BEFORE THE TAX COURT OF THE UNITED STATES

DECISION—June 13, 1960

Respondent having on May 4, 1960 filed a recomputation of tax for entry of decision in accordance with Memorandum Findings of Fact and Opinion herein, filed February 29, 1960, and this proceeding having been called from the Washington, D. C. calendar on June 8, 1960, and peti-

tioners not having appeared in opposition to respondent's computation, now, therefore, it is

Ordered and Decided: That there are deficiencies in income tax and additions to tax as follows:

		Additions to tax—I.R.C. 1939		
Year	Deficiency	Sec. 294 (d)(1)(A)	Sec. 294 (d)(1)(B)	Sec. 294(d)(2)
1952	$ 297.04	$2,664.07		None
1953	15,459.18	1,164.06	None	None

Clarence V. Opper, Judge.

Enter:

Entered Jun. 13, 1960.

Served Jun. 14, 1960.

[fol. 46]

BEFORE THE TAX COURT OF THE UNITED STATES

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR—
Filed September 7, 1960.

To the Honorable Judges of the United States Court of Appeals, Fifth Circuit:

Now come A. J. Whipple and Mildred Whipple, petitioners, and respectfully show:

Jurisdiction.

Petitioners, A. J. Whipple and Mildred Whipple, were during the calendar years 1952 and 1953, being the tax years involved in this petition, bona fide residents of the City of Houston, Harris County, Texas, and timely filed income tax returns for that year with the Collector of Internal Revenue, Austin, Texas, which is within the Circuit of the United States Court of Appeals, Fifth Circuit. A. J. Whipple and Mildred Whipple file this petition pursuant to the provisions of Section 7483 of the Internal Revenue Code of 1954.

Prior Proceedings.

On October 27, 1956, the Commissioner of Internal Revenue determined a deficiency in federal income taxes against petitioners, A. J. Whipple and Mildred Whipple, for the calendar year 1952 in the amount of $2,379.83, and for the calendar year 1953 in the amount of $17,625.78, and penalties aggregating $2,379.83, notice of deficiency being sent [fol. 47] to petitioners by letter dated that day.

Petitioners filed a petition for redetermination of these taxes in the Tax Court of the United States on January 22, 1957.

By admission, stipulation and agreement the issues to be decided by the Tax Court were (1) whether a $56,975.10 debt owed to petitioners in 1953 which became uncollectible in that year was a business or nonbusiness bad debt within the meaning of section 23(k), and (2) whether $3,349.50, paid by petitioners in 1953 to D. M. Dozier, was a deductible business expense or a capital expenditure. Petitioners abandoned, on brief, all alleged errors in regard to the imposition of additions to tax under section 294(d), except as to the correct amount of additions to tax due for 1953 under section 294(d)(1)(A) which could be resolved in accordance with Rule 50 after the major issues presented for the Court's decision were disposed of. Other issues raised by the pleadings were either conceded or resolved by stipulation.

The Tax Court of the United States rendered its decision on June 13, 1960, holding that:

1. The $56,975.10 bad debt loss in question was not incurred in any trade or business conducted by petitioners, and was instead a nonbusiness bad debt loss to be treated as a short-term capital loss under Section 23(k)(4) I.R.C. 1939;

2. The $3,349.50 paid D. M. Dozier were payments which were ordinary and necessary as compensation for contributing services and not a part of a commission on the purchase of specific property;

[fol. 48] 3. Respondent's determination of additions to tax under Section 294(d)(2) for the year 1952 were disallowed;

4. Respondent's determination of the addition to tax determined for 1953 under Section 294(d)(1)(A) were upheld;

5. Respondent's addition to tax determined under Section 294(d)(e) for the year 1953 was upheld;

6. Respondent's addition to tax for the year 1953 under Section 294(d)(1)(B) was disallowed.

Nature of the Controversy.

A. J. Whipple purchased the Mission Orange Bottling equipment and inventory of the Mission Orange Bottling plant in Lubbock, April 28, 1951, from D. C. Casey and assumed the lease on the premises at 2518 Avenue H, Lubbock, Texas. The franchise of Mission Orange Bottling Company was transferred to Petitioner A. J. Whipple individually and has been retained in his name individually to date. Mr. Whipple operated this plant for several months as an individual, but in June, 1951, because of the fear of personal liability from products being sold and to allow a few friends and associates to invest in a part of the business, organized Mission Orange Bottling Company of Lubbock, Inc., for the purpose of limiting liability. Mr. Whipple himself later personally operated a machine vendor operation selling Mission Orange bottling products through vending machines as a joint venture on the side with two employees of the corporation.

Unfortunately, the new plant did not result in as much increased production as anticipated and the hoped for price increase did not occur. During the year 1953 the corpora- [fol. 49] tion lost more and more money and by December 1953 was completely insolvent without enough assets to pay off its obligations. By that time the corporation owed Mr. Whipple $120,447.86 and outside creditors approximately $80,000.00. About the only assets of the corporation which were worth anything were the plant equipment. Therefore, on December 15, 1953, Mr. Whipple entered into an agreement with the corporation under which he took the plant equipment and credited the corporation with its approximate book value of $70,000.00 at the same time he paid into the corporation $48,000.00, which was enough to pay off all other current obligations.

After the equipment had been taken out of the corporation on December 15, 1953, the corporation had virtually no assets out of which his balance of $56,975.10 could be paid, and this bad debt thereby became worthless. The only hope then of salvaging anything was to be able to sell the plant and equipment, which he has tried unsuccessfully since that time to do. When this bad debt became worthless, therefore, Mr. Whipple was the owner of the building and all of the physical equipment of the plant and was actually managing the plant.

Over a period of years petitioner, A. J. Whipple, had promoted, organized, managed, financed, equipped, and loaned money in connection with numerous and varied enterprises, and continued to do so through the calendar years 1952 and 1953. Petitioner, therefore, treated the $56,975.10 loss as a business bad debt, but the Commissioner of Internal Revenue's Assessment of Deficiency was based on its being treated as a non-business bad debt and hence a capital loss.

D. M. Dozier was a Federal Housing Administration Field Superintendent on a construction job in which peti-[fol. 50] tioner was involved in 1951 and petitioner made him a proposition which brought Dozier to work for him on a salary, expense account, and a percentage of the profits (Tr. 95 and 96). The 15% profit sharing agreement was an across-the-board arrangement under which he got 15% of the profits of all joint ventures, partnerships, corporations and individual land deals in which petitioner had an interest except Whipple Lumber Company (Tr. 97).

In February, 1953, D. M. Dozier left petitioner's employ and in settlement was paid a total of about $29,000.00 for his share in the profits and anticipated profits in the various enterprises. In the case of the Westheimer land, $3,349.50 was 15% of the anticipated profits. The land had not been sold but it had gone up in value (Tr. 100). D. M. Dozier had not done any work on the Westheimer land but the anticipated profits from this land were used as a partial measure of his compensation in the over-all settlement (Tr. 99-100).

The Commissioner of Internal Revenue in assessing a deficiency charged the $3,349.50 to the cost of Westheimer

land, on which a long term capital gain was realized. This left the question of whether the $3,349.50 was properly an ordinary or a capital expenditure.

Petitioners respectfully submit that the finding of the Tax Court that the $56,975.10 loss for the year 1953 was a nonbusiness bad debt was erroneous, in that it was not supported by the evidence and is an erroneous conclusion of law from the facts and evidence presented at the trial of the case, as more specifically set forth in the assignments of error which follow. Accordingly, petitioners on review petition that the decision of the Tax Court of the United States be reviewed by the United States Court of [fol. 51] Appeals, Fifth Circuit, that a transcript of the record be prepared in accordance with the law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

Assignments of Error.

1. The Tax Court of the United States erred in finding that petitioner, A. J. Whipple, was not in the business of dealing in enterprises by promoting, organizing, financing, and managing corporations, partnerships, joint ventures, out of the conduct of which business the $56,975.10 bad debt loss resulted in the calendar year 1953.

2. The Tax Court of the United States erred in finding that petitioner, A. J. Whipple, was not in the business of financing corporations and lending money, out of the conduct of which business the $56,975.10 bad debt loss resulted in the calendar year 1953.

3. The Tax Court of the United States erred in finding that petitioner, A. J. Whipple, was not in the business of bottling soft drinks, out of the conduct of which business the $56,975.10 bad debt loss resulted in the calendar year 1953.

4. The Tax Court of the United States erred in failing to make any finding as to petitioners' contention that petitioner, A. J. Whipple, was in the business of acquiring, owning, expanding, equipping, and leasing bottling plants

and other equipment, out of the conduct of which business the $56,975.10 bad debt loss resulted in the calendar year 1953.

[fol. 52] 5. The Tax Court of the United States erred in finding that petitioner was not engaged in a combination of activities which together constituted a business, out of the conduct of which business the $56,975.10 bad debt loss resulted in the calendar year 1953.

A. J. Whipple, Mildred Whipple.

Duly sworn to by A. J. Whipple, jurat omitted in printing.

Duly sworn to by Mildred Whipple, jurat omitted in printing.

[fol. 53] Charles Dillingham, Ben H. Schleider, Jr., Attorneys for Petitioners.

Charles Dillingham, Ben H. Schleider, Jr., 802 Texas National Bank Bldg., Houston 2, Texas.

BEFORE THE TAX COURT OF THE UNITED STATES

NOTICE OF FILING PETITION FOR REVIEW—
Filed September 7, 1960

To: Mr. Hart H. Spiegel, Chief Counsel, Internal Revenue Service, Washington, D. C.

You are hereby notified that the above-named petitioner did on the 7th day of September, 1960, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Fifth Circuit, of the decision of this Court heretofore rendered in the above entitled case. Copy of the petition for review as filed is hereto attached and served upon you.

[fol. 54] Dated this 7th day of September, 1960.

Charles Dillingham, Attorney for Petitioners.

Acknowledgment of service (omitted in printing).

BEFORE THE TAX COURT OF THE UNITED STATES

STIPULATION OF FACTS—Filed April 21, 1959

It is hereby stipulated that the following facts are true, provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein.

1. Albert J. (also known as A. J.) and Mildred Whipple, husband and wife throughout the period herein involved, are residents of Houston, Harris County, within the Collection District of Austin, Texas, where they filed their joint individual income tax returns as more fully hereinafter set forth.

2. Albert J. Whipple, as head of the marital community within the meaning of the community property laws of the State of Texas, will hereinafter be referred to as petitioner.

[fol. 55] 3. In the income tax return of petitioners for the calendar year ending December 31, 1952, a deduction of $347.00 for dues for memberships in various organizations was claimed as a business expense. Petitioners and respondent stipulate and agree that such deduction be disallowed in determining the income tax deficiency of petitioners for the calendar year 1952.

4. Petitioners further agree that in the income tax return filed by petitioners for the calendar year ending December 31, 1953, petitioners claimed a deduction in the amount of $250.00 on account of a worthless oil and gas lease. Of the total claimed the sum of $186.61 is admittedly deductible, and it is so agreed by petitioners and respondent, but the balance of $63.39 should be disallowed as a deduction and petitioners and respondent so agree.

5. In the income tax return of petitioners for the calendar year ending December 31, 1953, a deduction of $145.00 for dues for memberships in various organizations was claimed as a business expense. Petitioners and respondent stipulate and agree that such deduction be disallowed in determining the income tax deficiency of petitioners for the calendar year 1953.

6. In the income tax return of petitioners for the calendar year ending December 31, 1953, petitioners claimed a deduction of $5349.50 as an ordinary and necessary business expense. This $5349.50 consisted of payments of $2000.00 to R. F. Jordan, $3349.50 to D. M. Dozier. Petitioners and respondent agree that the payment to R. F. Jordan in the amount of $2000.00 constitutes a part of the cost of acquiring land and should be added to the price of such property in computing the long term capital gain from the sale of such land, but as to the $3349.50 paid to [fol. 56] D. M. Dozier, petitioners reserve the right to prove by competent evidence that said sum was appropriately deducted as an ordinary and necessary business expense.

7. On May 11, 1951, petitioner acquired, as an original incorporator, $250.00 worth of the initial capital stock of Texas International Manganese Corporation. Petitioner paid $250.00 in cash for such stock. On April 30, 1953, the corporate charter of Texas International Manganese Corporation was forfeited for failure to furnish proof of final payment of all of the subscribed but unpaid for capital stock. Petitioner and respondent agree that such stock became worthless in the year 1953.

8. That as of December 31, 1953, Mission Orange Bottling Co. of Lubbock, Inc., was indebted to petitioner, A. J. Whipple, in the amount of $56,975.10, and that such debt had become worthless in 1953, and the sole issue remaining as to said sum of $56,975.10 is whether said sum is a business bad debt or a non-business bad debt within the meaning of Section 23(k)(1) or Section 23(k)(4), respectively, Internal Revenue Code of 1939.

9. On April 17, 1951, D. C. Casey, the owner of Mission Orange Bottling Co. of Lubbock, Inc., entered into an agreement, as seller, with A. J. Whipple, as purchaser, whereby D. C. Casey granted to A. J. Whipple an option to purchase Mission Orange Bottling Co., a proprietorship operated by Casey. A photostat of said agreement is hereto attached, marked Exhibit 1-A and made a part hereof.

10. One of the principal conditions of the Casey-Whipple purchase option, see Exhibit 1-A hereto, was that A. J.

Whipple obtain an assignment or a new lease from the [fol. 57] premises on which Mission Orange Bottling Co. was then conducting its business. By lease dated April 21, 1951, O. L. Nelms, the owner of the premises in question, entered into a lease with A. J. Whipple, as lessee, leasing the bottling business premises. A copy of this lease is hereto attached, marked Exhibit 2-B and made a part hereof. Another prime condition of the Casey-Whipple purchase option, see Exhibit 1-A hereto, was that A. J. Whipple obtained a franchise from Mission Dry Corporation, a Delaware corporation operating in the State of California, which franchise would authorize A. J. Whipple to distribute Mission Orange beverages. On April 25, 1951, Mission Dry Corporation granted a franchise to A. J. Whipple, doing business as Mission Orange Bottling Co., Lubbock, Texas. A copy of this franchise is hereto attached, marked Exhibit 3-C and made a part hereof for all purposes.

11. On April 27, 1951, D. C. Casey, pursuant to the purchase option previously granted to A. J. Whipple, see Exhibit 1-A hereto, transferred by bill of sale the machinery and equipment of Mission Orange Bottling Co., located at 2518 Avenue H in the City of Lubbock, Lubbock County, Texas, substantially according to the terms of the purchase option as shown by the excerpt from A. J. Whipple's books prepared by Mr. Edward Daniels of Ernst and Ernst, a photostatic copy of which is hereto attached as Exhibit 4-D1. A copy of the bill of sale from D. C. Casey to A. J. Whipple making the transfer is hereto attached, marked Exhibit 4-D2, and made a part hereof.

12. Upon consummation of the purchase option with D. C. Casey, A. J. Whipple assumed operations of Mission Orange Bottling Co., a sole proprietorship, and filed an assumed name certificate in Lubbock County reflecting that [fol. 58] A. J. Whipple was operating under the assumed name of Mission Orange Bottling Co. A copy of this certificate, dated April 27, 1951, is hereto attached, marked Exhibit 5-E and made a part hereof.

13. Mission Orange Bottling Co. of Lubbock, Inc., hereafter referred to as "Mission Orange", was incorporated

on June 8, 1951, under the laws of the State of Texas. The authorized capital stock was $20,000.00 represented by 200 shares of common stock of the par value of $100.00 per share. About the date of incorporation, $10,000.00, or 100 shares were issued for cash as follows:

A. J. Whipple	88	$ 8,800.00
Others	12	1,200.00
Total	100	$10,000.00

14. A. J. Whipple continued to operate Mission Orange Bottling Co. as a sole proprietorship from the date of its acquisition until July 1, 1951, at which time Mission Orange, the corporation which Whipple had previously chartered, became operational. A copy of the book entry setting forth the assets which Mission Orange, the corporation, acquired from the sole proprietorship is hereto attached, marked Exhibit 6-F and made a part hereof.

15. In late 1951 or early 1952 A. J. Whipple purchased a tract of land with a view of erecting a new bottling plant site, which construction was completed in the early portion of 1952. The land was acquired by A. J. Whipple personally at a cost of $4,589.75, and a bottling plant building was constructed at a cost of $39,011.95, for a total combined cost [fol. 59] of $43,601.70 to A. J. Whipple individually. On August 1, 1952, Mission Orange occupied the new plant under a lease obtained from A. J. Whipple. A copy of this lease dated July 14, 1952, is hereto attached, marked Exhibit 7-G and made a part hereof.

16. On December 1, 1951, petitioner acquired a restaurant known as "Cousins" which had been operating at 4401 Fannin Street, Houston, Texas. He continued to operate said restaurant until June 1, 1953, when it was sold or otherwise disposed of, according to the 1953 individual return.

17. Pursuant to a stockholders' meeting, the charter of Mission Orange was amended so as to increase its authorized capital stock from $20,000.00 to $40,000.00, which addi-

tional stock was divided in 200 shares each of the par value of $100.00, all of which additional stock was fully subscribed and 100% paid in in its entirety by A. J. Whipple in cash. This amendment was filed in the office of the Secretary of State December 8, 1952, and a copy thereof, marked Exhibit 8-H is hereto attached and made a part hereof.

18. Following such increase in the capital stock, the stock ownership on December 8, 1952, was as follows:

A. J. Whipple	308 shares	$30,800.00
Jas. A. Finly	10 shares	1,000.00
Charles Dillingham	2 shares	200.00
Cecil Clark	20 shares	2,000.00
Dora B. Ellzey	10 shares	1,000.00
D. M. Dozier	10 shares	1,000.00
Jack Knostman	20 shares	2,000.00
James F. Webster	20 shares	2,000.00
		$40,000.00

[fol. 60] 19. As of December 1, 1953, Mission Orange Bottling Co. of Lubbock, Inc., was indebted to A. J. Whipple in the amount of $56,975.10. A copy of the summary of how this indebtedness arises is hereto attached, marked Exhibit 9-I and made part hereof.

20. On December 15, 1953, Mission Orange by bill of sale transferred the bottling machinery and equipment described in an exhibit to the bill of sale. A copy of this bill of sale, marked Exhibit 10-J is hereto attached and made a part hereof.

21. The schedule, stipulations and W-2 Forms attached to petitioners' income tax returns of 1950 showed income received from the following enterprises as set forth in photostatic copy of same, marked Exhibit 11-K and made a part hereof.

22. The schedules and W-2 Forms attached to petitioners' 1951 income tax return show income received from the following sources:

Bottling Plant
Salaries received from 3 corporations
Schedule C Restaurant
Interest Received from 16 corporations, partnerships and individuals
Sales of interests in 13 corporations as shown in detail on copy of return, marked Exhibit 12-L made a part hereof.

23. On March 18, 1953, petitioners filed a joint individual income tax return, Form 1040, for the taxable year 1952. Photostat thereof is hereto attached, marked Exhibit 13-M, and made a part hereof, showing income from the following sources:

[fol. 61]

Form No.	Company	Exhibit No.
W-2	Whipple Lumber Company	13-M1
W-2	Whipple Construction Company	13-M2
W-2	Whipple Equipment Co., Inc.	13-M3
W-2	Angelton Homes Corp.	13-M4
W-2	Dozier-Whipple Const. Corp.	13-M5
1099	Federated Department Stores, Inc.	13-M6
1099	Durham-Clark Building Supply Co.	13-M7
1099	Whipple Lumber Company	13-M8

Interest received from 14 corporations, partnerships, and corporations:
Restaurant
Partnership
Lee County Oil Lease
Rent Purse Houston
Rental Building in Lubbock

24. Petitioner, A. J. Whipple was an original incorporator of the corporations formed on the dates set forth in letter from Secretary of the State of Texas to Charles Dillingham dated marked Exhibit 14-N and made a part hereof.

25. Petitioner, A. J. Whipple was an original incorporator of Angelton Building and Holding Corp., as shown by certified photostatic copy of Charter No. 109540 dated

February 25, 1952, hereto attached as Exhibit 15-O and made a part hereof.

26. After an examination, the revenue agent in a report dated June 1, 1955, photostat of which was transmitted to petitioners by the District Director, Austin, Texas, on September 16, 1955, disclosed deficiencies in and additions to tax for 1952 and 1953. Photostat thereof is hereto attached, marked Exhibits 16-P and 16-P1 and made a part hereof.

[fol. 62] 27. On February 8, 1956, petitioners executed and filed a "Consent, Form 872" for the taxable year 1952, which Consent was also executed by respondent. Photostat thereof is hereto attached, marked Exhibit 17-Q and made a part hereof.

28. On October 5, 1955, petitioners executed and filed a protest to the report dated June 1, 1955, previously referred to above. Photostat thereof is hereto attached, marked Exhibit 18-R and made a part hereof.

29. On October 22, 1956, by registered mail, statutory notice of deficiencies in tax and additions to the tax for the taxable years 1952 and 1953 were mailed to petitioners. A copy of said statutory notice, attached to the petition as Exhibit "A" is by reference attached hereto as Exhibit 19-S.

30. On January 14, 1954 petitioners filed a joint Declaration of Estimated Tax, Form 1040 ES, photostat of which is hereto attached, marked Exhibit 20-T1, and made a part hereof. On March 11, 1954 they also filed a joint individual income tax return, Form 1040, which is also attached, marked Exhibit 20-T and made a part hereof. In the schedules attached to the return income was shown as received by petitioner as follows:

Salaries from 6 corporations
Interest from 4 parties
One partnership
Rent from three properties

31. It is further stipulated that the issues pertaining to the capital loss on Texas International Manganese Cor-

poration stock, dues and subscriptions, $2,000.00 paid to [fol. 63] R. F. Jordan shall be disposed of by Rule 50 computation.

Charles Dillingham, Ben H. Schleider, Jr., Counsel for Petitioners, Arch M. Cantrall, FSG, Chief Counsel, Internal Revenue Service, Counsel for Respondent.

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 65603

[Title omitted]

Transcript of Hearing—Tuesday, April 21, 1959

(Met, pursuant to Calendar Call, at 2:50 o'clock p.m.)

Before: Hon. Clarence V. Opper, Judge.

APPEARANCES:

Ben H. Schleider, Jr., Esq., Charles Dillingham, Esq., 802 Texas National Bank Building Houston, Texas, appearing on behalf of Petitioner.

D. Louis Bergeron, Esq., (Hon. Arch M. Cantrall, Chief Counsel, Internal Revenue Service) 5000 Internal Revenue Building, Washington, D. C., appearing for Respondent.

[fol. 64] Proceedings.

The Clerk: Docket No. 65603, A. J. and Mildred Whipple. State your appearances.

Mr. Schleider: Ben H. Schleider, Jr. and Charles Dillingham for the Petitioner.

Mr. Bergeron: D. Louis Bergeron for the Respondent. Ready for trial.

The Court: You gave two names, but I see only one of you here.

Mr. Schleider: Mr. Dillingham just stepped out in the hall.

The Court: He will be here?

Mr. Schleider: Yes, sir.

The Court: Are you ready to proceed?

OPENING STATEMENT ON BEHALF OF PETITIONER

Mr. Schleider: Yes, Your Honor.

May it please the Court, we have heretofore stipulated, and with the exception of some brief comments, I will confine the bulk of my statement to the factual issues [fol. 65] which we understand to be before the Court at this time, aside from the stipulation.

This suit involves petition for deficiency for the calendar years 1952 and 1953 for Mr. and Mrs. Whipple. The calendar year 1952 has been admitted insofar as certain deductions, or stipulated insofar as certain deductions are concerned, and we have agreed they may be disallowed or should be disallowed.

As to the year 1952 there still is the question of penalties by reason of an improper estimate of tax.

Now, it's our belief that they, in the main, involve questions of law except to the extent that the evidence comes before the Court here in some other matters which will also bear on the estimate tax. We will introduce no independent evidence on that estimate for the failure to file an estimate.

There also is the matter of interest for 1952 which we likewise believe is a question law.

For the year 1953, the Commissioner determined a deficiency and the Petitioners have stipulated with Respondent that with the exception of two items, such deficiencies which were in the main entertainment, dues and the like, may be disallowed.

The two principal contested deductions are an item of $56,975.10 which was claimed by Petitioners as a business deduction and which the Commissioner disallowed and said should be treated as a non-business deduction, in other words, within the meaning of Section 23 (k) (1) or Section 23 (k) (4), respectively.

The second item is $3,349.50. This is out of an amount of $5,349.50 which was taken as a business deduction by Petitioners, and of the $5,349.50, $2,000 was stipulated

should be allowed, leaving the balance in controversy of $3,349.50.

[fol. 66] We believe as to that $3,349.50 the evidence will show and we will so attempt to show that it involved a portion of a profit-sharing arrangement with one D. M. Dozier which spread over several enterprises owned by A. J. Whipple.

The Court: Before you get into the merits here and while you are still on what the issues are, I would like to see if I can follow through on your petition. I am having difficulty.

I believe there was only one petition. Now, leaving—starting at the end and leaving out assignments or error G and H which refer to 1952—

Mr. Schleider: Yes, sir.

The Court: —and also leaving out F and E, which are the penalty assignments, as I read them—

Mr. Schleider: Yes, sir.

The Court: —that leaves A, B, C, and D to cover these matters that you say are still in issue.

Mr. Schleider: Yes, sir.

The Court: Now, A is an expense item—

[fol. 67] Mr. Schleider: That we have stipulated should be disallowed.

The Court: You have stipulated that out of the case?

Mr. Schleider: That's right.

The Court: B is set up not as—not as the issue that you state—but here it appears to be a question of whether it should be capitalized as an expense. Now, is that still the issue?

Mr. Schleider: As to $3,349.50 of the original $5,349.50. In other words, as to the man Dozier we say it still should be treated as an ordinary expense; as to the man Jordan, which represents $2,000, we have stipulated it may be disallowed and treated as a capital item, which is consistent in part with what the Commissioner determined.

The Court: Now, which is the one that you say is a 23 (k) item?

Mr. Schleider: We say the next item, which is C, involving $56,975.10—

The Court: It is set up as a bad debt item. I understood it was an attempt to take a bad deduction.

Mr. Schleider: It is a business bad debt.

[fol. 68] The Court: Is it conceded there was a bad debt?

Mr. Schleider: The stipulation which we will offer—

Mr. Bergeron: It's a question of whether it's a business bad debt or a non-business bad debt to the tune of $56,975.10.

The Court: Now, what about D?

Mr. Schleider: Now, D—and I might say here, Your Honor, there is an error, typographical error; that should be $250 instead of $2,500. But we have covered that by stipulation.

The Court: You mean that is out of the case?

Mr. Schleider: That is out of the case.

So we really have a part, to summarize, we have a part B to the extent of $3,349.50 involving a man Dozier. And as to the C, you have the question of business bad debt or non-business bad debt in the amount of $45,975.10.

The Court: Now, as I understand it, those are really the only two issues you will have evidence on.

Mr. Schleider: That is right, sir. We have confined ourselves to the unstipulated portion here, and I think as a matter of brevity it lends itself better to do it that way.

[fol. 69] The Court: Thank you.

Mr. Schleider: I might say on the $56,975.10 item which I will hereafter refer to as the bad debt item, for brevity, we consider there are three principal issues involved from which we will attempt to show by evidence and attempt to substantiate it:

Number one, the Petitioner, A. J. Whipple, was in the business, as the usual type of situation that is raised in these cases, of acquiring, financing, and organizing corporations.

Number two, that he was in the business of acquiring, owning, equipping, and leasing a bottling plant.

And number three—

The Court: You mean he, Petitioner?

Mr. Schleider: Yes, sir, Petitioner.

The Court: Not through a corporation?

Mr. Schleider: He was leasing it to a corporation, the bottling plant. And in addition to that, there is another facet of it, that he was also in the soft drink business.

Now, the second and third might be stated, alternative arguendo, but our argument is most helpful on the side that he was actually in the drink business.

The Court: You mean he as an individual?

[fol. 70] Mr. Schleider: When I say "he" I refer to Mr. Whipple, the Petitioner, as an individual.

I am not going to summarize a great deal of evidence because I don't think it would do anything but consume time. We can do that as well and rapidly from the witness stand itself. I will just say that in general, Mr. Whipple's operation and the ones we intend and hope to project before the Court here, cover a period of approximately fifteen years, that is, beginning approximately in 1940 and coming on through the year 1953. We may, in an isolated instance pass 1953 but not to any degree at all.

We will attempt to show by this evidence that Mr. Whipple was engaged in a number of corporate enterprises in which he actively managed those corporations, that he was involved in partnerships in which he participated as an active partner; that he was involved in a limited partnership in which he was a general partner; and that he generally was a man to whom business deals could be brought with a view of turning a profit.

He was more than an investor. I would say he bordered on a promoter category, and the evidence we believe will so show.

In addition to operating a bottling plant, as we choose to call it, we say Mr. Whipple was also engaged individually in the restaurant business. And while his activities involved the construction field and construction products and building products, he did go out into various deals, oil deals and various types of ventures.

The operations of Mr. Whipple insofar as the particular business at question is concerned relates to some advances which Mr. Whipple has made to Mission Orange Bottling Company, Inc. Now, throughout this record I would like to say here again, for clarity, that we will refer to Mission Orange as the corporation.

[fol. 71] There was also a time, and this was in the initial stage when Mr. Whipple himself, as an individual, did

business as Mission Orange in a sole proprietorship capacity. But when we say Mission Orange, we will refer to the corporation, because it has a rather long name and I thought that would shorten it, and that is the way we have treated it in the stipulation.

When we talk about "he" or the Petitioner, we are talking about Mr. Whipple, not only in his capacity as a private citizen, but Mr. Whipple in his capacity as Mission Orange Bottling Company, sole proprietorship.

Now, in addition to Mr. Whipple's operations, we believe the evidence will show he first started out operating as a sole proprietorship; he subsequently incorporated, but at all times retained the franchise. He made various advances which aggregated the net figure $56,975.10. And it's also stipulated that the debt was worth less in 1953 and that as of the close of that year, that sum of $56,975.10 was due and owing to him by Mission Orange.

As to the item on the Dozier matter, it will not take a great deal of evidence to develop. It was simply a question of what the profit-sharing agreement and arrangement was between Mr. Whipple and D. M. Dozier.

Unless His Honor has some questions and wants some clarification on points, I believe that concludes our opening statement.

OPENING STATEMENT ON BEHALF OF RESPONDENT

Mr. Bergeron: As to that D in paragraph four, we originally disallowed $2500 as being an unsubstantiated claimed cost of Texas Manganese stock. However, they were able to produce records which shows Mr. Whipple paid $250 for that stock, so in a computation that $250 will be reflected as a loss to Mr. Whipple on that particular stock.

Now, with reference—

[fol. 72] The Court: That is covered in the stipulation?

Mr. Bergeron: Yes. The closing paragraph of the stipulation shows what items will be made the basis of a Rule 50 computation.

The Court: Well, I hope it shows more than that, it shows how they will be disposed of.

Mr. Bergeron: Yes, sir, in a Rule 50 computation.

The Court: All right.

Mr. Bergeron: With reference to the $56,000, more or less, bad debt as of December 31, 1953, it is the Respondent's position that Mr. Whipple throughout his experience in the business world was not in the business of lending money; that he had made this investment and that he lost his money as a non-business bad debt, and that it was properly reflected in the statutory notices as a short-term capital loss.

With reference to Mr. Dozier's $3,349 50, it was shown in Mr. Whipple's own books as being a cost of a certain tract of land which was sold in 1953 and so reflected in the return; and we contend that the Respondent properly added that to the cost of the sale of that particular tract known as the Westheimer Tract, and the evidence will show it.

So that the only two issues before the Court really, this afternoon, are the $56,000 which whether it's a business or [fol. 73] non-business bad debt, and whether the Respondent properly determined that the payments to Dozier were additional costs in arriving at the capital gain from the sale of the Westheimer Tract.

The Court: Well—

Mr. Schleider: Let me just make this observation.

I was in error. I guess I had the impression, but I notice in looking at our copy of the deficiency notice, that $2500 was in there. I treated it as a typographical error, and I apologize to the Court.

Mr. Bergeron: I didn't mean to question your statement. I thought I would give the Court the facts.

The Court: Of course, I don't know yet what happens to the other $2,250 but I assume you covered that in your—

Mr. Bergeron: Yes. Somebody made a mistake.

Mr. Schleider: The typographical error was on the return. Not on the petition for deficiency. We have covered that.

The Court: We will take a ten-minute recess.

(Recess.)

[fol. 74] Mr. Schleider: May it please the Court, instead of presenting the stipulation in the normal order, I have

a gentleman I would like to put on the stand at this time in order that he might catch a 4:25 plane.

The Court: Do you have any objection?

Mr. Bergeron: No objection, Your Honor.

C. L. Barnhart was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

The Clerk: Have a seat and state your name and address, please.

The Witness: C. L. Barnhart, 3800 South Hills, Fort Worth.

Direct examination.

By Mr. Schleider:

Q. Mr. Barnhart, you know Mr. A. J. Whipple, do you not?

A. I do.

Q. When did you first make Mr. Whipple's acquaintance?

A. In 1951, I believe.

Q. What were the circumstances under which you made his acquaintance?

A. At that time, I was district representative for the Mission Dry Corporation, and Mr. Whipple was acquiring [fol. 75] or was fixing to acquire the Mission Bottling Company at Lubbock, and he was making application for a franchise.

Q. And what is Mission Dry Corporation?

A. They are manufacturers of bases for bottlers.

Q. Have you been in the bottling business for any length of time?

A. Since 1934.

Q. You have been in the bottling business consistently during that period of time?

A. Yes, sir.

Q. Are you presently engaged in the bottling business?

A. I am, sir.

Q. To what extent?

A. I have a plant in Fort Worth and I also have one in Wichita Falls, Texas.

Q. And in those plants you fabricate beverages, I mean, bottled beverages, soft drinks, and distribute them?

A. Yes, sir.

Q. Were you employed by Mission Dry Corporation?

A. Yes, sir.

Q. What was the nature and extent of your employment?

A. I was district representative for them for Texas and Oklahoma.

Q. And was Lubbock in your district?

A. Yes, sir.

Q. How long have you operated your own bottling plant?

A. Since May 5, 1934.

Q. And in addition to that, you have been connected with Mission Dry Corporation as a district representative?

A. Right.

Q. You said you made an acquaintance in early 1951 with Mr. Whipple, am I right about that?

[fol. 76] A. I believe it was either late 1950 or 1951.

Q. And where did you make his acquaintance?

A. In Houston, Texas.

Q. What were the circumstances that caused you two to come together?

A. I was on the road at that time for Mission, and if I recall correctly, I believe it was in Franklin, Texas, and the Mission Dry Corporation contacted me by telephone and told me that Mr. Whipple was acquiring the Lubbock plant, and asking for a franchise, and asked me to go to Houston and see Mr. Whipple as to whether I thought he would be qualified for a franchise.

Q. And did you make any investigation into Mr. Whipple?

A. Yes, sir, I did.

Q. What was the nature of your investigation?

A. I investigated him through the bank, through the Dun and Bradstreet, and through the Credit Association.

Q. What was the purpose of Mission Dry Corporation actually sending you out to find out about Mr. Whipple?

A. Well, to see if in my opinion Mr. Whipple was financially able to handle the bottling plant and if he had the business ability.

Q. Was that looking to the operation and management of a bottling plant at Lubbock?

A. Yes, sir.

Q. What did your investigation result in?

A. Well, after the investigation, I thought he was qualified for it and recommended to the company that they issue him a franchise.

Q. And was a franchise issued?

A. It was.

Q. Was it shortly afterwards?

A. Yes, sir.

[fol. 77] Q. And did you subsequently, after Mr. Whipple operated in Lubbock, did you have any occassion to deal with him further?

A. Yes, sir.

Q. What was the nature of your dealings with Mr. Whipple on the subsequent occasions?

A. Well, I had been several times called to Lubbock or had called Mr. Whipple and asked him to meet me in Lubbock in regards to the operation of the plant.

Q. What was your reason for doing that? Were you supervising the operation of the franchise and operation under it?

A. From a franchise standpoint only.

Q. You were concerned as the Mission Dry Corporation representative, with the manner in which the Lubbock bottling plant was being conducted under the franchise?

A. Right.

Q. Now, did this franchise continue from the time it was granted until December 31, 1953, in Mr. Whipple's name?

A. Yes, sir.

Q. Was the franchise issued to Mr. Whipple personally or to some corporation?

A. It was issued to Mr. Whipple personally.

Q. You know that of your own knowledge?

A. Yes, sir.

Q. On these occasions that you met with Mr. Whipple in Lubbock, Texas, what did you discuss with Mr. Whipple?

A. Well, I discussed the business operation of the business with him.

Q. And did you discuss anything about the affairs and manner of handling the business?

A. Yes, sir.

[fol. 78] Q. Are they the type discussions that you would have with the manager of a business?

A. No, sir. It was not from just—if you are referring to a resident manager or—

Q. I mean an overall general manager.

A. Yes.

Q. You had, I take it, several occasions to talk with Mr. Whipple; is that correct?

A. Yes, sir.

Q. In dealing on franchise matters connected with Mission Orange at Lubbock, did you go to Mr. Whipple in discussing those matters?

A. Yes, sir.

Q. You didn't discuss those with anybody on the ground necessarily?

A. No, sir.

Q. You have been in the bottling business and I take it you have had occasion through your twenty five years to observe people in the bottling business; is that right?

A. Yes, sir.

Q. And you are familiar with the operations of the bottling business, are you not?

A. Yes, sir.

Q. Would you say from the way you saw Mr. Whipple operate that he was a manager of a bottling business?

A. I would say he was.

Q. Would you say he was in the bottling business?

A. Yes, sir, I would.

Q. Isn't it a fact that Mr. Whipple operated pretty much like you do with respect to your Wichita Falls plant?

A. Yes, sir, he does.

Q. In other words, you live in Fort Worth, don't you?

[fol. 79] A. Right.

Q. And you have a plant in Wichita Falls?

A. Yes, sir.

Q. You have a local manager?

A. Yes.

Q. Do you consider you are in the bottling business in Wichita Falls?

A. Yes, sir.

Q. Did Mr. Whipple ever participate in any bottling conventions or anything of the sort?

A. Yes, sir, he did.

Q. Did you personally observe him at any bottling conventions?

A. Yes, sir.

Q. And did you discuss the bottling business with Mr. Whipple?

A. Yes, sir.

Q. Who made the major decisions up in the Mission Orange Plant in Lubbock after Mr. Whipple acquired it and started operating up there?

A. As far as I was concerned, Mr. Whipple did.

Q. And on major policy decisions, he would be the prime person to make those decisions?

A. Yes, sir.

Mr. Schleider: I believe I have no further questions.

Cross examination.

By Mr. Berger n:

Q. You state you were connected with the Mission Dry Corporation, is that it?

A. Yes, sir.

Q. Are you a stockholder of that Mission Dry Corporation?

[fol. 80] A. No, sir.

Q. What was your capacity with them?

A. District manager, or district representative.

Q. In addition to running your own bottling concerns?

A. Yes, sir.

Q. Were you on a salary with Mission Dry Corporation?

A. I was on a commission.

Q. You were on a commission.

And you stated that you saw Mr. Whipple on several occasions at bottling conventions?

A. Yes, sir.

Q. Do you know when those conventions were held?

A. Well, they were held in January; I couldn't tell the exact date.

Q. What year would you say?

A. 1951, 1952, and—

Q. You mean 1954 now?

A. I believe 1951. I can't recall the exact dates, but I know 1952.

Q. Because you stated that you contacted Mr. Whipple around April, 1951.

A. Yes, that was for a franchise.

Q. Was he at the convention in January prior to his becoming—

A. Well, I don't remember whether he was at the convention in 1951. He was in 1952.

Q. What other years did you see him at the convention?

A. Well, I saw him at the convention in 1953 and 1954, I believe.

Q. Did you have—were you in your capacity with Mission Dry interested in the management of the corporation owned by Mr. Whipple?

A. Beg your pardon?

[fol. 81] Q. Were you interested in any part of the business owned by Mr. Whipple known as Mission Orange Bottling Company?

A. No, sir.

Q. In other words, after you assisted him in getting this franchise, you were through more or less with Mr. Whipple, is that true?

A. From a monetary standpoint, if you mean from an investment, monetary standpoint, I had none.

Mr. Bergeron: I think that is all.

Redirect examination.

By Mr. Schleider:

Q. Mr. Barnhart, in connection with your operations with Mission Dry Corporation, once a franchise has been granted, did your duties terminate at that point?

A. Oh, no. My duties went on as long as there was a bottling plant existing, as long as I was calling on them.

Q. The purpose of that was to see the particular licensee or party with the franchise was operating according to the terms of the franchise, right?

A. Right.

Q. Wasn't that part of your job?

A. Yes, sir.

Q. I believe that is all, sir.

Mr. Schleider: No further questions.

Mr. Bergeron: I believe Mr. Barnhart could be excused now.

[fol. 82] Mr. Schleider: He is going to try to make a plane at 4:25.

The Court: Well, I hope you make it.

(Witness excused.)

STIPULATIONS BETWEEN PETITIONER AND RESPONDENT

Mr. Schleider: Your Honor, at this time I think we could introduce some stipulations between Petitioner and Respondent.

I might say that they are—that there are one or two documents that we need to have photocopied.

Mr. Bergeron: Yes, we may have to withdraw some.

The Court: Well, the originals are going to be with the stipulation until you put the copies in?

Mr. Bergeron: Oh, yes, you have a complete stipulation now.

The Court: And when you put the photostats in, they will show the number.

Mr. Bergeron: But what I want to do is take some copies for myself.

The Court: Withdraw them and resubmit the same documents.

Mr. Bergeron: Yes.

[fol. 83] Mr. Schleider: Yes.

The Court: Very well, that may be done.

Stipulation received.

What is the highest exhibit number?

Mr. Schleider: Just a minute, Your Honor. We have an oral stipulation too which goes—

Mr. Bergerbn: No. On the stipulation here it goes to 20-T and 20-T-1.

Mr. Schleider: What it is, we have two W-2 forms.

Mr. Bergeron: Estimated declaration and the Return, and we gave them the same number.

The Court: I hope it isn't going to confuse us. It would have been better to give us another number.

Mr. Schleider: I don't think it will, Your Honor, because it's stapled together.

Mr. Bergeron: It's stapled together, but we wanted to identify them separately without giving them a new number.

[fol. 84] The Court: In other words, 20-T is the highest number?

Mr. Bergeron: Yes, sir.

The Court: You say you have an oral stipulation?

Mr. Schleider: Yes, Your Honor.

I'd like to dictate this into the record; the style of the case—

It is hereby stipulated that the following facts are true, provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein:

(1) That although not actually in issue in the case, in order to avoid any possible confusion, Petitioner and Respondent do stipulate and agree that by December 31, 1953 Petitioner, A. J. Whipple, had paid to Mission Orange $30,800 for the capital stock of such corporation, and acquired an additional $1000 stock from another stockholder of Mission Orange, so that as of December 31, 1953, A. J. Whipple owned $31,800 capital stock as shown in the computation of tax for the year 1953 in the deficiency notice.

(2) That the work sheets of Edwin Daniels of Ernst & Ernst, an independent accounting firm, are correct excerpts of the books and records of A. J. Whipple and of the corporation known as Mission Orange, showing the advances made by Petitioner to Mission Orange and the disposition of such advances by Mission Orange, namely, the

[fol. 85] receipt of such advances by Mission Orange from Whipple and the disbursements thereof by Mission Orange.

Copies of such work sheets, marked Exhibit 21, containing thirteen pages, which said exhibit is hereto attached and filed with the clerk.

The Court: Now, that is all part of the stipulation?

Mr. Bergeron: We reserve the right to object to the materiality based on the testimony which may be adduced this afternoon. We agree those were the figures taken from the books in order to cut down the time of the trial.

The Court: You agree to what Mr. Schleider just said?

Mr. Bergeron: Yes, Your Honor.

The Court: You don't want me to rule on the materiality at this time?

Mr. Bergeron: Oh, no. I mean at the proper time, if we feel there is an objection to the materiality, I want to reserve the right to make it.

Mr. Schleider: We offer these records to show what they reflect under the business records rule, and if Your Honor [fol. 86] please, I would like to have the right to withdraw these and refile them after they have been photocopied. I will furnish Mr. Bergeron a copy of them.

The Court: Very well.

Suppose we mark that as an exhibit on the agreement of counsel that it may be received. That won't interfere with your objection on materiality.

The Clerk: Exhibit 21.

(Whereupon the document was marked for identification as Petitioner's Exhibit 21.)

Mr. Schleider: That doesn't diminish the Court's instruction there from our considering these as though they were the original business records?

The Court: I don't understand there is any question about that. That is the result of the stipulation. Marking them as an exhibit wouldn't affect it one way or the other.

ALEX W. HEAD, was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

The Clerk: Have a seat and please state your name and address for the record.

The witness: My name is Alex W. Head. My home address is 3826 Olympia Drive, Houston, Texas.

[fol. 87] Direct examination.

By Mr. Schleider:

Q. Mr. Head, you are acquainted with the Petitioner, Mr. A. J. Whipple, are you not?

A. Uh-huh, yes, sir.

Q. When did you first meet Mr. Whipple?

A. Mr. Whipple and I met in either late summer or early fall of 1950.

Q. And what were the circumstances or the occasion for your meeting him?

A. Mr. Whipple at that time was in some way associated with Mr. Miles Strickland and Mr. Whipple was in several side ventures, if you call them that, and—or—I forget the particulars; but I was called in in some form of discussion about he was in the process of disassociating himself from Miles Strickland so he could further his own ventures of a sort as I remember the particulars.

Mr. Bergeron: Your Honor, we don't know what this man is yet. We don't know the significance of his testimony.

Mr. Schleider: You haven't heard it all yet.

By Mr. Schleider:

Q. Mr. Head, would you tell the Court what your occupation is?

A. Oh, ostensibly I am in the oil business. But in the last few years, I have gotten into several other different ventures.

I have a mortgage company; I am a—I have a mineral company; we have a company with a couple of buildings

[fol. 88] in it. And take that as it may, what business would you say I am in? I really don't know.

Q. You are in a number of businesses?

A. I am in a number of businesses or sometimes they are in me. I don't know.

Q. Is that generally the type of operation you were carrying on in 1950 and subsequent years, particularly when you first met Mr. Whipple?

A. No. At the time I met Mr. Whipple I was primarily interested in the oil business. The fact of the business is after our first meeting, the next meeting I had with Mr. Whipple was, oh, either late 1950 or early 1951, when he and a group of people were promoting some kind or were in the process of promoting some kind of oil venture out in West Texas, and I was called in and asked if I would like to join with them in the promotion of the venture.

Q. And then when was the next time you had occasion to deal with Mr. Whipple?

A. Of course, you bear in mind some of these dates may be a little hazy. I can give you approximations only.

After that venture—

Q. You say that venture. To what—

A. I mean the West Texas venture that I referred to. We went into a venture in oil lease playup in Washington County. And shortly thereafter, almost about the same time a group of us, of which Whipple was a member, had leased a great quantity of acreage up in Lee County, which is one of the few counties in Texas on which oil has never been discovered; and we just promoted a glorious fiasco up there.

Q. Mr. Whipple was in the venture with you, is that right?

A. Yes.

[fol. 89] Q. Now, in the years 1952 and 1953, did you have occasion to deal with Mr. Whipple?

A. Well, after that venture, which lasted I guess through most of '51—

Q. You are now talking about the Lee and Washington County deal?

A. Yes, sir. After that, we were always discussing vari-

ous ventures of one sort or another. We saw a lot of each other during that time.

But about that time or prior to that, Mr. Whipple got into this bottling situation out in Lubbock. And he was having to spend a lot of time out there. And we didn't go into anything in the years 1952 and 1953, if that is primarily the years you refer to, because that thing was taking a lot of his time. He and I have gone into some things after 1953; we went into a lumber yard deal for a short length of time. And we have always had kind of a close association on trades.

Q. Let me ask you this: Have you ever discussed with Mr. Whipple any sort of manufacturing or fabricating deal or tire deal or anything of that sort?

A. Well, I should have told you that. In 1952—'53, I guess, right, it was right in there somewhere—we started to take over a kind of a sizable, well, they called it a cinder block business; it was a cinder block with a glassed front; take it over for the purpose of cleaning it up and selling it out. We worked at it for awhile and decided not to go into it; primarily, as I remember the particulars, Whipple was fightnig this tiger out in Lubbock.

Q. You refer to "this tiger out in Lubbock;" you are referring to the bottling company?

A. Subsequent events proved it to be.

Q. Mr. Head, did you discuss one or more deals with Mr. Whipple that never did consumate in any transaction? [fol. 90] A. Yes, Whipple and I were always discussing ventures of all sorts.

Q. I guess you would characterize Mr. Whipple as somewhat of a promoter type?

Mr. Bergeron: I move to strike the question as leading and suggestive.

The Court: Granted. Strike it out.

By Mr. Schleider:

Q. What kind of operator would you say Mr. Whipple was? I am talking about your own personal observation of him.

A. Mr. Whipple—

Mr. Bergeron: I object to the question on the ground that this witness hasn't proven that he is qualified to answer the question, based on his present testimony.

Mr. Schleider: Your Honor, he can always testify to his opinion of the type operation. I think that is just a shorthand rendition of facts.

The Court: I will sustain the objection.

The Witness: Now, what is the question again? It skipped me here.

[fol. 91] The Court: The objection has been sustained. You don't have to answer.

The Witness: Oh, I see. All right, sir.

By Mr. Schleider:

Q. Mr. Head, do you consider that you are somewhat of a promoter?

A. Well, I think the term "promoter" can be used rather loosely. I think I am one who gets groups together to do a certain—to perform a certain function for which I am paid for my services. If you call that being a promoter, I very definitely am.

Q. Well, do you in the course of your type operations do any actual managing or overseeing or actual direction of these operations that you get together?

A. Well—

Mr. Bergeron: I object on the ground the question is not material to whether Mr. Whipple is in that type of business or not.

Mr. Schleider: Your Honor, the objection previously was the man was not qualified to give an opinion. Now I am trying to qualify him as a promoter so he can give an opinion.

The Court: I still don't think it's material. I will sustain the objection.

[fol. 92] By Mr. Schleider:

Q. Did Mr. Whipple operate on generally the same sort of lines that you operated?

Mr. Bergeron: I move to strike. This witness hasn't shown he is qualified to testify as to Mr. Whipple's operations.

The Court: I think we are going to get into trouble going at it this way. Certainly we can get the testimony of exactly what Mr. Whipple did. This witness knows some of the things he did. And basically, what you are asking him to do is to make the decision I have to make, whether from the facts you bring out here Mr. Whipple was a promoter in the sense in which it's used in the cases.

Now, this witness couldn't help me any on that. And whether his business is similar to Mr. Whipple's or different wouldn't be material, as I can see, to this proceeding. Maybe Mr. Whipple is a promoter and this witness isn't.

I will sustain the objection.

By Mr. Schleider:

Q. Mr. Head, in connection with the various deals that you took to Mr. Whipple, did you take them to Mr. Whipple for his services that would be involved in connection with those deals?

Mr. Bergeron: I object again. The question is not material.

Furthermore, there have been no deals shown as attaching to the two years involved which would make this testimony enlightening to the Court in deciding the question of whether Mr. Whipple was a promoter or not.

[fol. 93] Mr. Schleider: He talked about a tire deal, Your Honor, and he also, as I understand cases, it's not a completely narrow corridor between a specific date or at a specific time he must have been operating as a promoter type man. It's rather an overall operation which can cover not only—

The Court: I think you are mistaken about that. I think it has to be an overall operation for him to succeed. The fact he isn't in that business the year he takes the loss, I think the cases hold it to be regarded as part of his business. We have got so far from the question now I can't remember what it was.

Mr. Schleider: I asked him—he had testified he took these deals to Mr. Whipple, various and sundry deals, and I think he did testify he did.

The Court: I don't think you can say it is immaterial provided it was before the last year we've got.

By Mr. Schleider:

Q. Prior to 1953, and I am referring to prior to December 31, 1953, the deals that you took to Mr. Whipple, were they taken to Mr. Whipple with the idea of getting him to contribute his services in putting the deals together?

A. There is no question about that. "Whip" is a cracking good money-raiser. That is the reason I took the deals to him, to join me and help promote the deals.

Q. You didn't take them to him solely as an investor?

A. He didn't have that kind of money.

[fol. 94] Mr. Schleider: I believe that's all.

Mr. Bergeron: No questions.

The Court: Thank you, Mr. Head.

(Witness excused.)

Mr. Schleider: If nobody has any objection, Mr. Head can be excused if it is agreeable with the Court and Mr. Bergeron.

Mr. Bergeron: No objection, Your Honor.

The Court: Very well.

Mr. Schleider: Your Honor, I anticipate that starting with Mr. Whipple will probably take us an hour or an hour and a half. If the Court wants to complete him this afternoon, we will go ahead.

The Court: Is it either or can we go ahead for maybe half or three-quarters of an hour and pick him up again in the morning?

Mr. Schleider: We could; if the Court had no objection I would prefer to put him on so we could hear his full testimony at one time. But I guess there is no objection—

[fol. 95] The Court: An hour wouldn't bother me, but when you say an hour and a half, it may be two hours and—

Mr. Schleider: I am anticipating there will be considerable cross examination too?

The Court: Are you talking about cross examination too?

Mr. Schleider: I am talking about in addition to direct.

The Court: How about putting him on direct?

Mr. Schleider: I am anticipating that would be an hour or an hour and a half on direct.

The Court: I would prefer you to put him on.

Mr. Schleider: I am reluctant to start in the middle there. I lose my continuity.

The Court: I don't want to assure you I will sit an hour later until you get through.

Mr. Schleider: Could I just do this, put on Mr. Daniels, the accountant, for about fifteen minutes in connection with these records. I did want to get an explanation from him [fol. 96] which is consistent with our stipulation and I think that will bring us about fifteen or twenty minutes down the road. I don't think—

The Court: Well, I have a lot of work here, Mr. Schleider, and I would like to sit until somewhere around a quarter of 5:00 or 5:00 o'clock.

Mr. Schleider: Well, I will put Mr. Daniels on and if there is time left, we will put on as much as we can.

The Court: All right. Unless you want to put Mr. Whipple on and hope you can complete it.

Edwin C. Daniels was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

The Clerk: Will you have a seat, sir, and state your name and address for the record, sir.

The Witness: My name is Edwin C. Daniels; my home address is 75 Hibury, Houston, Texas.

Direct examination.

By Mr. Schleider:

Q. Mr. Daniels, what is your occupation?

A. I am an accountant with the firm of Ernst & Ernst.

Q. Are you a certified public accountant?

[fol. 97] A. Yes, sir.

Q. And are you licensed by the State of Texas?

A. Yes, sir.

Q. Your license is in good standing.

A. I hope so.

Q. So far as you know?

A. So far as I know it's in good standing.

Q. You have a degree in business or in accounting from an accredited university?

A. Yes, sir.

Q. Where did you graduate and when?

A. Well, I graduated from Millsaps College in Jackson, Mississippi in '52—in '42 with a B.A. degree, majored in economics and took graduate degree from the University of Houston and received my Master's Degree there.

Q. Has all your education in the college been in the field of accounting?

A. Yes.

Q. How long have you been a certified public accountant?

A. Since 1950 or 1951.

Q. And prior to that time how long have you been engaged in the accounting profession?

A. Well, prior to that time, of course in 1942 I finished school and was called into the service and got out in '46 and from '46 to 1948 I was going to the University of Houston taking graduate work; and in 1948 I went to work in the accounting as such, and since that time I have been in the accounting business.

Q. Have you been with just that firm of Ernst & Ernst?

A. No, I was in another business before that time.

Q. You were in the accounting department though?

A. Yes.

[fol. 98] Q. I requested that you prepare, in the interest of time, certain excerpts and schedules from the books of A. J. Whipple and Mission Orange, is that not right?

A. Right.

Q. And I will show you now exhibit of Petitioner No. 21, consisting of some thirteen-odd pages, and you tell me if that is the summary you prepared?

A. Yes, that is the summary I prepared.

Q. I want you to go through that summary very briefly, page by page, and as briefly as possible tell me the function of the particular schedule on page 1, for example.

A. Well, may I say something introductory to that that might be some explanation?

Q. Yes, sir.

A. I think the point to be determined was that these advances Mr. Whipple had made to Mission Orange Company were actually received by Mission Orange Company, deposited in their bank account and used to pay subsequent bills with that.

In order to establish that, we looked at the records of Mission Orange Bottling Company and traced these advances which he had made into their cash account and into the bank statement and into the cash disbursements book to determine the disposition that had been made.

On page one, for instance, is the advance made October 29, 1951, in the amount of $5,000; and that was received by Mission on October 29, 1951.

Now, at the time of the advance, the balance in the bank account of First National Bank of Lubbock, which was the depository for the Mission Orange Bottling Company, showed an overdraft of $1,279.31. The sales and collections during the month of October, 1951, exclusive of the advance, amounted to $17,301.69, making a total available cash then to pay bills of $16,022.38.

[fol. 99] The disbursements made during the month of October, 1951 were as follows:

Trade notes and accounts, $18,129.98.

And the payroll shown by their payroll journal, $3,660.12; a total of $21,790.10, leaving a cash overdraft before the advance of $5,767.72.

The advance came in of $5,000 and left an overdraft at the end of October, 1951 of $767.72.

Now, from the cash disbursements books, I listed the payments which had been made in the amount of two hundred or over in order to reduce the quantity of the items, because there were a number of small items of ten and fifteen dollars.

Q. These were disbursements by whom?

A. Mission Orange.

Q. That is what page one deals with in the main, is what, cash received by Mission Orange?

A. And cash disbursed by Mission Orange.

Q. You also show on that the condition of the bank account at the time the disbursements or deposits were made?

A. Right.

Q. All right.

Now,—

A. Shall I—

Q. I don't think it's necessary for you to go down each item there because the exhibit speaks for itself. But I wanted you to give an explanation.

A. That was to determine the advances had been received by Mission Orange and the money did go to Mission Orange's bank account and Mission Orange did pay for the operation of Mission Orange Bottling Company.

Q. What does your next page reflect, page two of Exhibit 21?

[fol. 100] A. Page two shows an advance of $4,000 that was made to Mission and received by Mission on January 23, 1952, which advance went into Mission's bank account in the First National Bank at Lubbock, and that, preliminary to the advance, the cash account in the bank showed an overdraft of $3,661.60, and with the cash advance brought them with a balance January 31, 1952 of $338.04.

Q. Now, you have talked on page one and you are starting out on page two of Exhibit 21, Petitioner's Exhibit, and you have referred to advances. What do you have reference to when you use the word "advance"?

A. Well, a check drawn by Mr. Whipple payable to Mission Orange Bottling Company, check on Mr. Whipple's personal account in Houston, Texas payable to Mission Orange Bottling Company at Lubbock.

Q. What I am getting at is you refer to advances by Mr. Whipple, is that right?

A. Right.

Q. All right, sir.

A. These are all, all these sheets show the different advances he made during that period of time, and the fact Mission did get the money and did spend it.

Q. All right, sir.

Now, did you prepare any summaries in connection with those exhibits there or just the detail sheets?

A. Well now, the summary sheets I think you already have. They are not part of these. Those were prepared for the examining agent.

Q. I show you Joint Exhibit 9-I and ask you if you prepared that Exhibit 9-I?

A. Yes, sir, I prepared Exhibit 9-I.

Q. And what is Exhibit 9-I?

A. Well, Exhibit 9-I is captioned: "Summary of Account Due from Mission Orange Bottling Company, A. J. and [fol. 104] Mildred Whipple, period from July 1, 1951 to December 31, 1953," and the first sheet is a summary of it and shows the nature of the advances to Mission Orange Bottling Company and the amount of payments which Mission made to Whipple, and then the net amount of the loss incurred by him of $56,975.10.

Q. Well now, what else does your summary show—I am referring now to Exhibit 9-I, Joint Exhibit, as per the stipulation, on the second page, for example, it has more than one page, doesn't it?

A. Well, for instance, let's read the caption on the first page, and behind it are the details underlying the first page.

Q. All right.

A. Sale of assets, of net assets to corporation, Mission Orange Bottling Company of Lubbock. Now, that was the sale by Mr. A. J. Whipple of the Mission Orange at the time it was a proprietorship, to Mission Orange Bottling Company, a corporation, in June of 1951.

And the net assets of the proprietorship, Mission Orange, were $25,502.50. That is the first item.

Q. Is that June or July of 1951?

A. Well, June 30, 1951 was the actual closing entry on Mr. Whipple's records and July 1, 1951 is the date of the opening entry of Mission Orange Bottle Company, the corporation records.

Q. As far as you are concerned, Mission Orange Bottling Company, Inc., a corporation commenced business on July 1, 1951?

A. That's correct.

Q. All right.

A. And the second item, cash advanced since date of incorporation, as shown by schedule, $103,300—even.

And I have on page 2 then a listing of the advances made by Mr. Whipple to Mission Orange Bottling Company, the [fol. 102] date of those advances, the check number, and the purpose of the advance, and the amount advanced, all of which adds up to $103,300.

Q. That was the total amount of money Mr. Whipple had advanced to Mission Orange, is that right?

A. That's right, plus expenses paid by Mr. Whipple for the account of company in the amount of $2,975.76. These are expenses which were actual Mission Orange Bottling Company of Lubbock, Inc. expenses which he paid out of his own pocket and charged to them, totaling up $2,975.76, $25,502.50, plus $103,300 even, and the total is $131,778.26.

Now, less payments to A. J. Whipple by the corporation, as shown by schedule, $74,803.16, the net result, of course, is the total of $56,975.10.

On page 3 of this exhibit are the repayments which were made to Mr. Whipple by Mission Orange.

Q. The $56,975.10 represents what now?

A. That represents the excess of the advances which he had made over and above the repayments which Mission made to him.

Q. Now, is that carried on Mission's books as a receivable to A. J. Whipple or rather payable?

A. It's a payable.

Q. Is that shown on Mission Orange books as a debt to A. J. Whipple?

A. Yes, yes.

Q. On your Exhibit 9-I, if you will let me refer to that a moment, please, sir, there is some cash advances here, and I notice that one of them is dated August 22, 1952, which is an advance to which I now indicate.

Can you tell me by whom that advance or rather, how that advance was made?

A. Well, that particular advance you are talking about—let me read it; it shows paid to A. J. Whipple Construction Company. The date is August 22, check numbers none. [fol. 103] Purpose of the advance—advance made by A. J. Whipple Construction No. 2 to Mission Orange for account of A. J. Whipple, personal, $10,500.

Well, in going into Mission's records and into Mr. Whipple's records, it was found this $10,500 consisted of three separate advances which A. J. Whipple Construction had made to Mission for Mr. Whipple's account, and they charged it to him on their records and he picked it up on his records as a liability to A. J. Whipple Construction Company, and a receivable from Mission Orange Bottling Company. Mission Orange Bottling Company recognized it as a debt owing to A. J. Whipple.

Now, those three items—I will have to refer to the detail on it. One was for $5,000 and one was for $4,000 and one was for $1,500, as I recall it. But they were separate advances made in 1951, October 29, 1951, for $5,000, and January 23, 1952 of $4,000, and February 4, 1952 of $1500. total $10,500.

Q. Were there any similar advances on Exhibit 9-I that were made in the same manner?

A. Well, yes. You have one other one there to D. M. Dozier which was a payment to D. M. Dozier on February 4, and it was really a reimbursement to Mr. Dozier by Mr. Whipple for $1,250, such sum having been advanced by Mr. Dozier to Mission Orange for Mr. Whipple's account.

Q. But in every instance Mr. Whipple, himself—

A. And there is another item there which is a direct payment to the First National Bank at Lubbock, October 4, 1952, check 450, which was in payment of a note for the account of Mission due the First National Bank of Lubbock for $4,050.

Q. Mr. Daniels, do you have any summary as such, a composite summary that shows the method or manner in which Mission Orange used these funds, that is; what were [fol. 104] they used to pay, in the main, the funds that A. J. Whipple advanced?

A. Well, what they used were used to pay—I think they are shown on Exhibit 21, page 1. Each page of the exhibit shows they were paying Kimbell-Lubbock for sugar that went into the drinks; Al W. Townsend for truck expense; and Mallory's Laundry & Uniforms. That's what they were using the money for. Here is one payable to the First National Bank for a note of Mission Orange.

Q. Now, turn to the December 31, 1952 sheet. Do you have one for that particular—

A. December 31, 1952?

Q. Yes, sir. Or 1953, I should say.

A. 1953?

Q. Yes, sir. Could you briefly cover that?

A. The disbursements that were made?

Q. Yes.

A. There again, the disbursements were made to the—shall I list the names of the vendors that were being paid?

Q. Just briefly give us an example.

A. Kimbell-Lubbock for supplying the sugar. Merchants East Freight. Here is one $18,991.42 to the bank in payment of Mission's note.

Here is one to Mason & Mason for concentrate. And KUEB for T V Advertising. Parker Brown Company in the amount of $2,421.40 for CO2 Gas.

Here is one to Owens Glass Company for $2,939.82 for bottles, and so on. I mean—

Q. Those are typical of the type of expenditures?

A. Spent in excess of $200, $48,768.71 for expenditures.

Q. In your schedule, which is 9-I, I may have interrupted you a little early on this. You were talking about advances [fol. 105] by the construction company No. 2 and advance by Dozier for the account of Whipple, personally.

A. Yes.

Q. In each instance, I think there was one other—

A. There was one Buckner Equipment Company.

Q. In each instance, A. J. Whipple, personally, was ultimately, by bookkeeping transactions, charged and paid the advance, is that right?

A. Yes, he had to stand the advance.

Q. Now then, in connection with the—you've got here on the first page of Exhibit 9-I some payments by A. J. Whipple or to A. J. Whipple by the corporation, and you list a total of $74,803.16.

A. Yes.

Q. How did that principally come about?

A. How did that what?

Q. I say how did that $74,803.16 principally, that credit of $74,000 on the books of A. J. Whipple—

A. Well, the two principal items, if that is what you

want, consisted of one item, December 31, 1953, of $67,332.91 which was the equipment of Mission Orange which he took title to, which they sold to him. He bought it for $67,332.91 as partial satisfaction of the amount which they owed him.

Q. Mission Orange owed Whipple?

A. Right. And the other item is an automobile which he bought in partial satisfaction, $3,081.75, in partial satisfaction of the amount they owed him.

Q. Any cash payments on these advances by Mission Orrange to A. J. Whipple?

A. Yes.

Q. What did they total, if any?

A. I don't have a separate total of those, but I can give it to you.

Q. Give me the approximate amount.

A. $4,500.

[fol. 106] Q. That was the total cash Mission Orange at any time paid Whipple?

A. Yes, sir.

Q. What kind of equipment did Mission Orange transfer to A. J. Whipple, and about when did that occur?

A. Well, it occurred in December, 1953, and the type of equipment was the bottling equipment which they had in their plant there. They had no other assets. They had no cash. The receivables were very low, if any, so the only asset they had of any value was the bottling equipment; so he just took title to the bottling equipment.

Mr. Schleider: I have no further questions.

Cross examination.

By Mr. Bergeron:

Q. Those figures in Exhibit 9-I and the summary sheets, Exhibit 21, where were they taken from, what were they taken from?

A. The figures in Exhibit 9-I, is that the—may I have them back?

Q. That summary you were looking at.

Mr. Schleider: I think the record reflects our stipulation is that it was taken from the books of the corporation, Mission Orange, and also from A. J. Whipple.

Mr. Bergeron: Yes.

The Witness: Let me have that.

[fol. 107] By Mr. Bergeron:

Q. You prepared that?

A. The figures in this 9-I, which is the summary of the advances Mr. Whipple made to Mission Orange, the source of this information were the records of Mr. Whipple.

Q. Not the corporation?

A. We then, in turn, traced these entries into the corporation's records.

Q. You were engaged by Mr. Whipple to go and make an examination of that corporation known as Mission Orange, were you not?

A. We were not engaged in making an examination of Mission Orange.

Q. What were you engaged to do?

A. I don't understand.

Q. According to this schedule, advances by A. J. Whipple for account of Mission Orange Bottling Company, there was a payment on August 4, 1953 to Ernst & Ernst. That is your company, is it not?

A. That's right.

Q. Auditing service, $1,503.68.

A. That was a separate engagement though; in 1953, Mr. Whipple called us and said he had a suspicion that there may have been a defalcation at Mission Orange Plant in Lubbock and would we send some of our men up there to check out the defalcation. The $1,503.68 you are referring to, auditing service, was for that specific purpose in checking out and determining the amount of the defalcation.

What I am driving at is that the total of the advances here, the examination which was made for which he paid the $1,503.68, was separate and apart from the preparation of this particular schedule.

[fol. 108] Q. Then you are answering my question that you were the firm of—you were, the firm of Ernst & Ernst were engaged to check Mission Orange, isn't that true?

A. A specific examination of this defalcation.

Q. I didn't ask you if it's specific or otherwise. You did check?

A. Right.

Q. Your figures on this schedule are as of the date December 31, 1953.

A. Right.

Q. Was the corporation still in existence after that date?

Mr. Schleider: I object to that, Your Honor.

Mr. Bergeron: It's part of the picture.

Mr. Schleider: No, it is not.

In this case we have stipulated that the debt was worthless in 1953; that was a debt in the amount of $56,975.10. And I don't think any reference to what happened thereafter is material.

The Court: Why would it be material, Mr. Bergeron?

Mr. Bergeron: To show that the company was still in existence.

The Court: Well, that is what you asked about.

[fol. 109] Mr. Bergeron: Yes.

The Court: Why is that material?

Mr. Bergeron: To give the entire picture of the transaction, to see whether Mr. Whipple had abandoned that corporation as of December '53.

The Court: Why would that make any difference?

Mr. Bergeron: It may for the purpose of my argument.

The Court: For the purpose of showing what?

Mr. Bergeron: Showing that it is a continuing company.

The Court: Why is it material whether the company is continuing or not, if the debt is worthless?

Mr. Bergeron: On the theory that he was till putting money in the corporation after that date.

The Court: Which contradicts the stipulation that—proving that it wasn't worthless.

[fol. 110] Mr. Bergeron: I want to show that they continued to put money into that corporation after December 31, 1953.

The Court: Well, there is only one purpose in showing that, isn't there? And that is that it wouldn't be considered worthless?

Mr. Bergeron: No. I say in determining whether the business was continuing.

Mr. Schleider: I fail to see that. That is the big thrashing on this whole stipulation. We thought we had that horse buried the other day, because the stipulation specifically provides, and I am quoting in part:

"That either party may introduce other and further evidence not inconsistent with the facts herein.

"No. 8—"page four of the stipulation: "Mission Orange Bottling Company—"

Mr. Bergeron: The existence of the corporation after December 31, 1953 would not be inconsistent with the fact we have—with the facts we have stipulated.

The Court: It would not be. Let's assume it wouldn't be. But then, it's immaterial.

Mr. Bergeron: It would have a bearing in my argument in the brief.

[fol. 111] The Court: You have to show me what it is, Mr. Bergeron. Up to now, I haven't been able to see.

I will sustain the objection.

By Mr. Bergeron:

Q. You stated that Mr. Whipple bought the equipment at book value on December 31, 1953. Is that true, in your testimony?

A. Yes. I don't recall the date of the bill of sale, but the entry on the books was December 31, 1953.

Q. And the term you used was that the equipment was bought by Mr. Whipple, is that right?

A. Yes.

Q. By "bought" do you mean a journal entry was entered in the books to show that this equipment to the tune of the $67,332.91, was transferred by journal entry to Mr. Whipple in part consideration of the advances which he had made, is that what you meant by it or do you mean that he paid cash on that date for that equipment?

A. Well, of course, the consideration which he paid had actually already been paid to the corporation in the form of these previous advances.

Q. But not for the equipment?

A. But in order to satisfy the debt to him of some $131,000, he, in turn, acquired this equipment here of some $67,000.

Q. And a journal entry to that effect—

A. To record the bill of sale and also to record the fact he had received that much of the obligation.

Q. That would be true also as to the automobile?

A. That's right.

Q. What is shown as book value on Exhibit 9-I?

A. Right.

[fol. 112] Q. Therefore, as of that date, there was no cash that passed hands between Mr. Whipple and Mission Orange for that particular equipment and automobile on that date.

A. Well, on December 15 he had advanced $48,000 and on this particular date he took title to the equipment.

Q. In other words, on December 31, there was—

A. No additional cash was passed on that date.

Q. You also stated that all of the equipment was bottling equipment. Is that true, on December 31, that was turned over to Mr. Whipple, is that true?

A. Well, Mr. Bergeron, I would have to see a copy of the bill of sale to itemize the equipment. It's equipment that goes into a bottling plant. I don't know you could confine it to a particular piece of equipment.

Q. I show you Exhibit 10-J which is a bill of sale dated December 15, 1953, to which is attached a list of equipment. Is that the equipment that changed hands on the journal entry, or do you know?

A. Yes. This is the equipment. I don't see anything on there that would not be bottling equipment.

Mr. Bergeron: No further questions.

Redirect examination.

By Mr. Schleider:

Q. Mr. Daniels, I want to correct what may be mostly a misimpression on my part or else I think there is an impression that is not entirely accurate from what you just testified.

As I understand, the schedule 9-I, Exhibit 9-I, $74,803.16 you say was represented in part by a transfer of equipment

[fol. 113] from Mission Orange, the corporation, to A. J. Whipple, the individual, in December 1953.

Is it your testimony that this transfer occurred on December 31 or on the date of the bill of sale?

A. The entry was not made on the books—I mean, we didn't make the entry on the bookkeeping until the end of the month. She made the entry at the end of December to record the sale of equipment from Mission Orange to Mr. Whipple, and the entry on the books was made on December 31.

Q. Now, do you know whether or not Mr. Whipple made any substantial advance on December 15, 1953?

A. Yes. He advanced $48,000.

Q. And if the bill of sale was dated December 15, 1953, would you have any reason to doubt that was not also the date of the transfer of the property from Mission Orange to Mr. Whipple?

A. No.

Q. Any delay from December 15 to December 31 would simply be occasioned by bookkeeping lag, is that right?

A. That is all.

Q. Or the closing entries?

A. That's right.

Q. So also, at the end of the month, would be a normal bookkeeping lag, is that right?

A. Yes.

Mr. Schleider: That's all.

Recross examination.

By Mr. Bergeron:

Q. And you prepared this Exhibit 9-I?

A. Yes.

[fol. 114] Q. That is your handiwork?

A. That's right.

Mr. Bergeron: That is all.

Mr. Schleider: I believe I have no further questions.

Mr. Bergeron: That is all, Your Honor.

The Court: All right.

(Witness excused.)

Mr. Bergeron: But I don't believe the witness should be excused.

Do you?

Mr. Schleider: Well, I won't excuse him. I mean, I won't until the Court excuses him. He will stay here.

Your Honor, could I start with Mr. Whipple in the morning?

The Court: I'd like to go ahead for awhile.

Mr. Schleider: All right.

Mr. Whipple.

[fol. 115] A. J. WHIPPLE, was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

The Clerk: Will you have a seat, sir, and state your name and address, please.

The Witness: My name is A. J. Whipple; my address is 2707 Nottingham, Houston.

Direct examination.

By Mr. Schleider:

Q. Mr. Whipple, you are the Petitioner in this case, are you not?

A. Yes, sir.

Q. Your full name is Albert J. Whipple, is it not?

A. Yes, sir.

Q. And what is your wife's name?

A. Mildred Whipple.

Q. And you were married to Mrs. Whipple during the years 1952 and 1953, is that right?

A. Yes, sir.

Q. Mr. Whipple, when did you start business for yourself? When did you go into business for yourself?

A. 1941.

Q. Prior to 1941, what sort of work had you been doing?

A. I had been working as a construction superintendent and estimator for a lumber company, Stafford Lumber Company in Pasadena, Texas.

Q. Stafford Lumber Company in Pasadena, Texas?

A. Yes, sir.

[fol. 116] Q. All right, sir.

After you left Stafford Lumber Company, what did you do then?

A. Well, I was engaged in a building partnership with W. E. Brown in 1941 up to the early part of 1942.

Q. Were you engaged in that partnership with W. E. Brown at the time you were working with Stafford?

A. We were building houses more or less on the side, yes, sir.

Q. And after you left Stafford Lumber Company, I take it you and Mr. Brown went together on a full-time basis?

A. Yes, sir.

Q. Now, how long did you and W. E. Brown build together?

A. About a year.

Q. Did you operate as a partnership or a corporation or—

A. Partnership.

Q. Did you have a name for your partnership?

A. I believe that at that time we operated all in W. E. Brown's name due to the fact we had started that while I was with Stafford Lumber Company, and I received part of the profits.

Q. All right, sir.

You state you stayed with W. E. Brown about a year?

A. Yes, sir.

Q. Was that a fifty-fifty basis?

A. Yes, sir.

Q. You had no corporation?

A. No, sir.

Q. All right, sir.

Now, after the end of a year, what did you do?

A. Well, before I left Brown, Miles Strickland had approached me to build a 608 housing project in Greens Bayou for which I was to receive twenty-four per cent of the stock [fol. 117] of the corporation and also a percentage of the profits for building the houses, which were built in a partnership with Miles Strickland, W. C. Perkins and myself, of which I had twenty-four per cent interest in the partnership; Mr. Perkins twenty-five, and Strickland fifty one.

Q. Under what name did you operate?

A. S.W.P. Construction Company.

Q. I take it that stood for Strickland, Whipple, and Perkins?

A. Yes, sir.

Q. All right, sir.

Did you have any interest in any corporation or corporations about this time?

A. Well, Mr. Strickland had formed Industrial Homes, Inc., which was the company which was to own the 608 housing project; and I had the privilege of buying into that for a percentage of it, which eventually was thirty-three per cent.

Q. Did you subsequently buy into it?

A. Yes, sir.

Q. Into the corporation.

That was Industrial Homes, that was the name of that corporation?

A. Industrial Homes, Inc.

Q. All right, sir.

And that was formed about what year?

A. 1942.

Q. All right, sir.

And how long did you have an interest in Industrial Homes?

A. Until 1951.

Q. All right, sir.

Now, between 1942 and 1951, did you have an interest in any other corporations other than Industrial Homes?

[fol. 118] A. Well, the latter part of 1943 we formed a Harbor Homes, Inc., and we took over and finished 63 housing units in Meadwood Estates. That was a job started by Miller Estes Company out of Oklahoma City, and they went bankrupt, and it was taken over by Guardian Trust Company, a bonding company out of Detroit, which we made a trade and completed, bought the property from the bank and completed it. And Harbor Homes, Inc., in turn, completed the houses and sold them on contract and finally got rid of the houses.

Q. What interest, if any, did you have in Harbor Homes?

A. 40 per cent.

Q. You had 40 per cent of the stock?

A. Not in the beginning. I bought in for 40 per cent.

Q. And did you have any—were you employed by Harbor Homes initially?

A. No, sir, because we didn't draw any money out of it until it was completed. We had Industrial Homes completed, and the salary that I got at that time came from that corporation.

Q. That is, from Harbor Homes?

A. From Industrial Homes.

Q. From Industrial Homes?

A. Yes, sir.

Q. Now, how long did Harbor Homes, Inc. stay in business?

A. I think it's still in existence. I was out of it in 1951.

Q. Now, in 1943, you say you formed Harbor Homes, Inc. Did you form any other corporations in 1943?

A. Well, over a period of nine years, Mr. Strickland and I had Industrial Homes, Inc., Harbor Homes, Inc., S & W Construction Company, a partnership; S & W Construction Company, Inc., a corporation; Evergreen Rice Company, a partnership; Richmond Plaza, Inc.: Air Line Lum-[fol. 119] ber and Supply Company, Ltd.; and Air Line Lumber and Supply Company, Inc.; and Shakertown Distributors, which was a partnership.

Q. How do you spell that?

A. S-h-a-k-e-r-t-o-w-n.

Q. All one word?

A. Yes, sir.

Q. Shakertown what?

A. Shakertown Distributors which, if I am correct, was a partnership.

We had 29th and Air Line, Inc.

Q. 29th and Air Line?

A. Yes, Inc., which was a corporation that owned the property where Air Line Lumber was.

Q. It owned the real estate?

A. It was a real estate and building holder.

Q. Who were the tenants?

A. Air Line Lumber and Supply Company and Shakertown Distributors were both tenants. We also had Gulf

Coast Plumbing and Supply Company, which was a plumbing contracting firm.

Q. You had Gulf Coast Supply Company?

A. Gulf Coast Plumbing and Supply Company.

Q. That was a partnership?

A. That was a plumbing contractor.

Q. Was that a partnership or a corporation?

A. I believe it was a partnership. I am not positive. We had another partnership, State Tile Distributors.

Q. Do you remember when you formed that State Tile Distributors?

A. Either 1947 or 1948.

Q. How did you happen to form State Tile Distributors?

A. Well, for several years, a local tile contractor, by the name of Listi, had went after me to promote a wholesale tile company; and the proposition looked good, so I took [fol. 120] the proposition to Mr. Strickland and it looked good to him; and in the meantime, we took his brother, Bentley Strickland and formed a four-way partnership; and Bentley Strickland eventually took over the management of it. And after the death of Mr. Listi it had to be reorganized, and so it was a three-way partnership.

Q. How did you happen to come to form this State Tile Distributors, or State manufacturing concern?

A. We were buying tile from Indiana—

Q. Yes.

A. And it was during the time tile was allocated and hard to buy. We decided if we controlled our source of supply, it would be a good operation. So we took a trip and went to, first, to Cincinnati, Ohio and talked to one manufacturer and he wasn't interested. We next stopped at Anderson, Indiana; and after two days we made a deal with a sales manager by the name of Ellis for National Tile Company at Anderson, Indiana.

Q. How did you—what kind of deal did you make with him, how did you go about making a deal?

A. Well, we had an appointment with him one morning and tried to arrive at something. And finally, he wasn't too much interested, but we carried him to lunch, and after we had a few drinks and a little lunch and did a little more talking, we offered to buy so many seconds and so many

firsts, and finally it got interesting to him and we offered to let him draw a draft on us for four carloads of tile, which was about $50,000, and he became more interested. And the next morning, we had three cars of tile rolling and he didn't want to sell us any when we first went there.

Q. You kinda talked him into it?

A. We tried.

Q. At the time you were up there in Indiana, had State Tile Distributors actually been formed?

[fol. 121] A. We didn't have a name while we were up there looking for a deal; we formed the name for it while we were eating lunch. And after that, the next day they had checked our bank credit of—I think they checked S & W Construction Company or Air Line Lumber, and I told them to draw a draft on S & W Construction Company.

Q. And they would send the merchandise on down to Houston?

A. That's right, yes, sir.

Q. Let's go back just a minute.

I noticed that you talked about S.W.P. Construction Company. That was when Mr. Perkins was involved?

A. That was a partnership.

Q. Now, Perkins, I take it, withdrew from that partnership, is that right?

A. Yes, sir.

Q. And is that what came to be known as S & W Construction Company?

A. Eventually we did have S & W Construction Company.

Q. Was S & W Construction Company a partnership or a corporation?

A. We had both on S & W.

We also had a Whipple & Strickland, and Whipple Construction Company, Inc.

Q. Did you own an interest in all those ventures, the partnerships you described and the corporations too?

A. Yes, sir. After the first two, of Industrial Homes and Harbor Homes, with the exception of three 608 apartment projects, which I failed to tell you about, I had an equal interest with Mr. Strickland in all of them.

[fol. 122] Q. That is all these corporations, Richmond Plaza, Air Line Lumber and Supply Company, Inc., and 29th and Air Line, Inc?

A. Yes, sir.

Q. And any other corporations that subsequently followed, is that right?

A. Yes, sir.

Q. Now, you mentioned something here about Evergreen Rice Company being a partnership. What was Evergreen Rice Company?

A. That was a partnership we formed when we were building—I believe it was forty-three houses on the corner of Evergreen and Rice on a ten-acre tract of land in the city of Bellaire.

Q. And that was a partnership with you and Strickland?

A. With me and Strickland.

Q. Any other partnerships involved in that—or rather, any other partners involved in that partnership?

A. No, sir.

Q. All right, sir.

Now, what was Shakertown Distributors?

A. That was a company formed to distribute shingles and also it had John W. Anderson in it. John W. Anderson was the third person in Air Line Lumber and Supply Company.

Q. Well, now, you have also got here an Air Line Lumber and Supply, Ltd. and Air Line Lumber and Supply Company, Inc. What is the difference?

A. Air Line Lumber and Supply Company, Ltd. is our first venture there due to the fact Mr. Strickland wanted to limit his liabilities when we first went into the buliding material business.

Mr. Anderson—I originally owned the land where Air Line Lumber and Supply Company is located, and held [fol. 123] title to the land about seven years after it was started.

Mr. Strickland, to start with, wanted to limit his liability and we had a limited partnership which eventually was turned into a corporation.

Q. In other words, Air Line Lumber and Supply Company, Inc. is the successor of Air Line Lumber and Supply Company, Ltd., is that right?

A. Right.

Q. But the limited partnership was limited as to the liability of Mr. Strickland?

A. Yes, sir.

Q. Who were the general partners in Air Line Lumber and Supply Company, Ltd.

A. Myself and John W. Anderson.

Q. Now, how did you happen to come to form that Air Line Lumber and Supply Company, Ltd.? Was that at the instance of Mr. Strickland or—

A. Well, I had bought this property with the intention of building in a building materials yard; and Mr. Strickland wasn't interested in going into that business or didn't seem so at that time. So there was quite a bit of red tape to go through all the dffierent agencies to get a permit to go into the building business with everything still allocated.

Knowing I wanted to keep from being tied down, I took John W. Anderson in as a full partner, and was going to give him fifty per cent of the lumber business to run it.

After Strickland found out I was serious and really going into the lumber business, he wanted a part of it. And then I asked Anderson if he minded a third party being in it. I had told Strickland I had to get permission. And when he said he would go along that way, we formed it and split it three ways.

[fol. 124] Q. As best as you recall, about when was Air Line Lumber and Supply Company, Ltd., formed?

A. We unloaded the first load of lumber that went in on July 4, 1945.

Q. Does that date have some significance to you?

A. Yes, sir, because I unloaded it, myself.

Q. All right, sir.

When did you form S & W Construction Company, Inc.?

A. I presume that was formed about '43 or '44. I don't recall.

Q. All right, sir.

Then you say that Air Line Lumber and Supply Company was a successor to Air Line Lumber and Supply Company, Ltd.?

A. Yes, sir.

Q. When was the corporation formed, do you have any recollection?

A. Of what now, sir?

Q. When was Air Line Lumber and Supply Company, Inc. formed?

A. I would say about 1949, about four or five years after we formed the partnership.

Q. In other words, you operated the limited partnership, Air Line Lumber and Supply Company, Ltd., a period of some four or five years and then formed the corporation which bore the same name?

A. After that, we had enough money to form a corporation with enough capital to operate. To start with, we didn't have any money at all.

Q. How did you get your financing?

A. Well, in the beginning of Air Line Lumber and Supply Company, Ltd., Mr. Strickland and I advanced money out of partnerships, like, S & W Construction and Evergreen Rice Company.

[fol. 125] Q. Did you generally make necessary advances to these corporations as you formed them pretty much as a general plan or scheme in their operation?

A. Well, when you form a thousand dollar corporation, you don't borrow any construction money from the bank; you have to get it from somewhere. We had these partnerships which we had from the beginning. We would take this money and advance it to the various corporations as construction money.

Q. Then I take it you would be paid—

A. When the job was completed and it would go back into the partnership.

Q. Was that a general method that you used in forming all these corporations?

A. We did for a period of about ten years.

Q. Well, now, how long did State Tile Distributors stay in existence?

A. It's still in existence.

Q. Did you have any interest in State Tile Distributors?

A. I sold my interest in 1951.

Q. What about Shakertown Distributors, you say that is a partnership?

A. Yes.

Q. About when was that formed?

A. About 1948.

Q. And what was Shakertown Distributors engaged in, what sort of activity?

A. They were wholesale distributors for a brand of cedar shakes made on the West Coast.

Q. What did you do, just sell these shakes?

A. We bought them and sold them wholesale to dealers in the Houston area.

Q. You sold them to people who were in the market, retail market for cedar shakes?

[fol. 126] A. Most of them were sold to retailers for resale; it was a jobbing deal.

Q. It wasn't part of your construction operations though, was it?

A. No, it wasn't even part of the lumber company. It was a separate operation and separate office.

Q. Well now, who did Shakertown Distributors rent their offices from?

A. 29th and Air Line, Inc., the holding company that owned the property.

Q. And Air Line Lumber and Supply Company, Inc. also rented from them?

A. They rented from 29th and Air Line, Inc.

Q. And you had an interest in 29th and Air Line, did you not?

A. Yes, sir.

Q. How long did the partnership known as Evergreen Rice Company stay in existence?

A. I would say from about 1945 until 1951.

Q. I noticed that in a number of these instances, and in practically every one of these, you listed here, you indicate that your interest in the various ventures with Mr. Strickland terminated about 1951; is that correct?

A. We had a meeting of the minds the latter part of 1950 and reached our final settlement the first six months in 1951.

Q. And what, in the way of settling your affairs with Mr. Strickland, what were generally the mechanics of the settlement?

A. Well, he bought every corporation that we had—I think this what you are asking me—every corporation that we had, he bought my interest at book value. Is that what you mean?

Q. In other words, Mr. Strickland bought you out?

A. Mr. Strickland bought me out right down the line. I didn't retain any property or any corporations.

[fol. 127] Q. Did that apply to all these partnership ventures?

A. Everything we had together was liquidated.

Q. On the date of liquidation in 1951, at the time you sold to Mr. Strickland, I am going down this list and you tell me whether or not you had an interest at that time in these various ventures.

Did you have an interest in Industrial Homes, Inc.?

A. Thirty three and a third per cent.

Q. That was in 1951?

A. Yes, sir.

Q. Did you have an interest at that time in Harbor Homes, Inc?

A. Forty per cent.

Q. And did you have an interest in S & W, the partnership?

A. Yes, sir.

Q. Did you have an interest in S & W Construction, Inc., Construction Company, Inc.?

A. Yes, sir.

Q. Did you have an interest at that time in Evergreen Rice Company, partnership?

A. Yes, sir.

Q. What about Richmond Plaza, Inc.

A. Yes, sir.

Q. You had an interest?

A. I had an interest in Evergreen; I had an interest in everyone.

Q. And Air Line Lumber and Supply Company, Inc.?

A. Yes, sir.

Q. Incidentally, that limited partnership terminated when you formed the corporation?

A. When we formed the Air Line Lumber and Supply Company, Inc.

Q. What about Shakertown Distributors, a partnership?

A. Yes, sir.

[fol. 128] Q. And what about 29th and Air Line, Inc.?

A. Yes, sir.

Q. You had an interest in that?

A. Yes, sir.

Q. Mr. Strickland bought that in 1951?

A. Yes, sir.

Q. And what about Gulf Coast Plumbing and Supply Company?

A. That final return—it only operated two years; it was a bad venture and it was losing money. I believe it folded in '49.

Q. I take it from that, it started about 1947 then?

A. Yes, sir.

Q. All right, sir.

Did you personally have any money in Gulf Coast Plumbing and Supply Company?

A. I don't recall.

Q. Did you have an interest as a partner in that company?

A. I evidently did. It showed on my tax return one year, but I don't remember that. But I do know there was such a company.

Q. How about State Tile Distributors, did you—

A. I sold that in 1951.

Q. All of the interest you have enumerated here you sold to Mr. Strickland in 1951, is that right?

A. Yes, sir.

Q. After you sold your interest, what did you do then?

A. Well, I bought property on Bissonnet and formed Whipple Lumber Company; also bought land at Angleton and started back in the construction business.

I bought a restaurant on Fannin Street in April, 1951; I bought a bottling plant in Lubbock. Later on in 1951 I bought some land in Bellaire. In 1951 I bought some land in Pasadena.

[fol. 129] We formed—we had a partnership, A. J. Whipple Construction Company, we had a building corporation, Dozier-Whipple Construction Company; we had another building corporation, Whipple Construction Company, Inc.; and another one, Angleton Homes, Inc.; another one by the name of Chevy Chase Development Corporation; another one by the name of Angleton Building and Holding Company; another partnership by the name of A. J. Whipple Construction Company No. 2. I believe that's all since 1951.

Mr. Schleider: Your Honor, I think this might be a good breaking point. I suggest to the Court because it opens up a new line of testimony.

The Court: I think that is a good idea, and perhaps you won't have too much trouble in finding your place tomorrow morning.

Mr. Schleider: Thank you very much.

The Court: We will take a recess until tomorrow morning at 10:00 o'clock.

(Whereupon, at 5:05 o'clock p.m., the hearing in the above-entitled matter was adjourned to Wednesday, April 22, 1959 at 10:00 o'clock a.m.)

* * * * * * *

[fol. 130] Proceedings.

The Clerk: Docket No. 65603, A. J. Whipple and Mildred Whipple.

The Court: Proceed with the case on hearing.

[fol. 131] A. J. WHIPPLE, resumed the stand and was examined and testified further as follows:

Direct examination (Continued).

By Mr. Schleider:

Q. Mr. Whipple, yesterday, shortly prior to the conclusion of yesterday's testimony, you were discussing some various enterprises in which you and Mr. Miles Strickland had been associated.

I am referring to Joint Exhibit 12-L, which is the income tax return of you and Mrs. Whipple for the year 1951.

And in connection with the capital gains schedule, I note a corporation listed as Federal Road Lumber Company, Inc. What was that corporation?

A. That was a retail building materials yard on Federal Road and Green Bayou.

Q. And did you have an interest in that corporation?

A. I owned one-third of it.

Q. And who owned the other interests?

A. Mr. Strickland and Mr. Anderson.

Q. They owned the other two-thirds?

A. Yes, sir.

Q. In similar proportion?

A. Yes, sir.

Q. I see on here also a Federal Road Building Corporation. What was that?

A. That was a construction company we used in building houses.

Q. And did you own an interest in that too?

A. Yes, sir.

Q. Was that a third?

A. No, sir. That was a half.

Q. You owned half of the stock in that corporation?

A Yes, sir.

[fol. 132] Q. Who owned the remaining half?

A. Mr. Strickland.

Q. Now, also listed down here is Commonwealth and California. What does that refer to?

A. That is a .608 apartment job, ten-year apartment house on the corner of Commonwealth and California.

Q. What was that? Was that a corporation?

A. A corporation.

Q. And you owned stock in that, did you?

A. (No response.)

Q. You have listed it here.

A. Evidently I did.

Q. You have listed a capital gain on the sale and disposition of that corporation.

A. Yes. We had two apartment houses out there.

Q. You owned, I take it, an interest in that corporation; is that right?

A. Yes, sir.

Q. How about Commonwealth and Missouri?

A. Yes, sir. That was another 608 apartment.

Q. When you say 608, what do you refer to?

A. Federal Housing Administration Title 608, Rental Apartments.

Q. I see.

There is also listed a Riverside Apartments Corporation on your—

A. That was another Federal 608.

Q. That was another corporation you had an interest in?

A. Yes, sir.

Q. I noticed also, and I don't think any of these you mentioned yesterday, a corporation, apparently, Dorwayne Construction Corporation, under your capital gains schedule, it indicates you acquired stock in that corporation on May 16, 1950 and disposed of it in 1951. What was Dorwayne Construction Corporation?

[fol. 133] A. It was a residential construction company.

Q. And who were the owners in there besides yourself?

A. Mr. Strickland and, if I am correct, Mrs. Bruce, who was Mr. Strickland's secretary, and myself.

Q. Now, I am not sure whether we covered this yesterday; but I see the corporation listed here also, Richmond Plaza, Inc. in which you purported owned an interest. What ownership did you have in that corporation?

A. If I am correct, forty seven per cent. I believe that is one we had a field superintendent with a six per cent interest in it.

Q. I see.

Well now, did you ever make any loans to any of these corporations that I have mentioned, for example, let's take the one I just talked about, Richmond Plaza, Inc. Did you ever make any loans to them?

A. Well, the parent companies and the partnerships.

Q. And through the partnerships you loaned them money?

A. No. The partnership would loan these corporations money.

Q. The partnership?

A. Evergreen-Rice, 29th and Air Line, Inc., S & W Construction Company. They were the holding company,

but the main partnership, why, Evergreen-Rice Company and S & W Construction Company.

Q. Did you in each of these corporations I have referred to here this morning, make one or more loans from the partnership to those corporations?

A. We were constantly lending money for construction purposes to all of them.

Q. And as I believe you testified to yesterday, when the construction job was completed, then that loan was paid to the particular partnership?

[fol. 134] A. Yes, sir.

Q. Is that correct?

A. Yes, sir.

Q. I am again referring, Mr. Whipple, to Exhibit 12-L, which is a joint exhibit attached to the stipulation of Petitioner's and Respondent, and refer to the schedule of income from interest.

Now, on this income from interest schedule attached to your return, Exhibit 12-L, you list in 1951 as having received interest from Whipple Lumber Company, Inc., Dozier-Whipple Construction Company—Dozier Whipple Construction Corp., rather, Whipple Construction Company, Inc., Angleton Homes, Inc., A. J. Whipple Construction Company, Whipple Equipment Company, Inc., and Durham-Clark Building Supply Company.

Now, with regard to the last one, what was Durham-Clark Building Supply Company? Was that a partnership?

A. That was a material partnership of which I had none of the—the only thing I did, I lent them money to operate on.

Q. You had no interest in the partnership?

A. No, sir.

Q. You owned none of the capital in the partnership?

A. No, sir.

Q. Now, what about A. J. Whipple Construction Company, what sort of a—

A. That was a construction partnership.

Q. That was not a corporation?

A. No, sir.

Q. And you did have an interest in that, I take it, from the name?

A. Beg your pardon?

Q. Did you have an interest in the A. J. Whipple Construction Company?

[fol. 135] A. Yes, sir.

Q. Do you recall who the partners were in the A. J. Whipple Construction Company?

A. V. L. Yarborough, L. R. Olive, G. A. Durham, and myself, I believe.

Q. Was Mr. Dozier a partnership—was Mr. Dozier a partner of Whipple Construction Company?

A. He was a partner of Whipple Construction No. 2, not of the original.

Q. Now then, these corporations—and they appear to be corporations from the listing here—did you have an interest, for example, in Whipple Lumber Company, Inc.

A. Me?

Q. Yes.

A. Yes, sir.

Q. You were a stockholder in the corporation?

A. Yes, sir.

Q. And how about Dozier-Whipple Construction Corporation?

A. Yes, sir.

Q. You owned an interest as a stockholder in that corporation?

A. Yes, sir.

Q. And Angleton Homes Corporation?

A. Yes, sir.

Q. You owned a stock interest in that corporation?

A. Yes, sir.

Q. And Whipple Equipment Company, Inc.?

A. Yes, sir.

Q. You were a stockholder there?

A. Yes, sir.

Q. Now, all of these corporations and partnerships that you have listed on the interest income schedule to your 1951 return, Exhibit 12-L, were for loans that you made [fol. 136] to those particular corporations and partnerships; is that right?

A. Yes, sir.

Q. And did you do that on just an isolated instance or was that done on more than one occasion?

A. Well, it was done on numerous occasions.

Q. What is Whipple Equipment Company, Inc.?

A. Whipple Equipment Company was a corporation formed to buy and lease equipment, trucks, construction equipment, such as, bulldozers, equipment of that kind.

Q. Well, by whom or by what was the equipment used?

A. The equipment was used by the various corporations that we had that needed that equipment, such as, lumber companies and construction companies.

Q. I see.

Well now, who was the principal user of or lessee of Whipple Equipment property.

A. A. J. Whipple.

Q. You, yourself?

A. Well, the corporations and the partnerships.

Q. I see.

Did Whipple Lumber Company, Inc. use any of that equipment?

A. They had at one time some six or seven trucks and two or three automobiles that belonged to the equipment company, under lease.

Q. Well now, did the various entities, partnerships or corporations using this equipment of Whipple Equipment Company, Inc., pay a rental on that equipment?

A. They paid a monthly rental based on the national rates. I don't know what they were.

Q. And did Whipple Equipment Company, Inc. have any other source of income or revenue except from the particular rental on equipment that they made?

[fol. 137] A. That is all.

Q. That was their sole source of business?

A. That's right.

Q. And sole source of revenue?

A. Right, sir.

Q. Where is Whipple Lumber Company, Inc. located?

A. 2436 Bissonnet, in Houston.

Q. Who owns those premises?

A. Sir?

Q. Who owns the premises?

A. I own the property and the buildings where it is.

Q. In other words, Whipple Lumber Company, Inc. is on a piece of land, real estate, with buildings and warehouses that you own, is that right?

A. Yes, sir.

Q. And you pay taxes on that, ad valorem taxes?

A. Yes, sir.

Q. Do you receive any rental for that particular piece of property?

A. Yes, sir.

Q. How long have you owned that property known as 2436 Bissonnet?

A. February 13, 1951.

Q. You acquired it February 13, 1951?

A. Yes, sir.

Q. I take it you acquired it then after you left Mr. Strickland?

A. Yes, sir.

Q. Did you acquire it for the purpose of doing business?

A. Yes, sir.

Q. And did you own 2436 Bissonnet in the years 1952 and 1953?

A. Yes, sir.

Q. You have owned them before and after those years, is that right?

[fol. 138] A. Yes, sir.

Q. And has rental been paid to you by Whipple Lumber Company—

Mr. Bergeron: I object to the question. The return speaks for itself and it shows renewal rental paid to Whipple and 12-L does not show any income from the Whipple Company or anybody else in the schedule.

The Court: I didn't understand the question as what the returns show, but what the facts are. If the facts develop rentals were received and weren't reported, then you know what you can do.

By Mr. Schleider:

Q. Mr. Whipple, included in your income for 1951 on which you paid taxes—

The Court: Well now, I am sorry to interrupt you. Wasn't there an answer?

Mr. Schleider: No. I didn't get the answer to that question.

Would you read the question, please.

(Question read.)

By Mr. Schleider:

Q. Would you answer the question?

A. Rental on the property at 2436 Bissonnet?

Q. Yes, sir.

A. Yes, sir.

[fol. 139] Q. And whenever you received that rental, you reported in your income tax return, is that right?

A. Yes, sir.

Q. All right.

Mr. Bergeron: I withdraw the objection, Your Honor.

By Mr. Schleider:

Q. Was this arrangement whereby you owned the property known as 2436 Bissonnet in any way similar to the 29th and Air Line arrangement with Air Line Building and Supply Company where they owned the land and rented it out to the lumber company?

A. Yes, sir.

Q. Did any of these other corporations listed in your return in which you received rental income—excuse me—interest income, occupy the premises known as 2436 Bissonnet?

For example, does Whipple Construction Company occupy 2436 Bissonnet? Was that the home office of it?

A. That is the home office of every corporation we had, sir.

Q. And did any of those corporations besides Whipple Lumber Company, Inc., pay rental to you, or was rental paid solely by the lumber company?

A. I don't recall any rent ever being paid by anyone other than Whipple Lumber Company.

Q. Mr. Whipple, I am now referring to Joint Exhibit 13-M, which is your tax return, your individual tax return for the calendar year ending December 31, 1952.

In connection with that particular tax return, I refer to your interest income schedule which indicates that you had interest income from A. J. Whipple Construction Company—now, that was a partnership, wasn't it?

[fol. 140] A. Yes, sir.

Q. You had it from Whipple Lumber Company, Inc.; that was your lumber company doing business at 2436 Bissonnet; is that right?

A. Yes, sir.

Q. And Durham-Clark Building Supply Company, the partnership.

A. Yes.

Q. And Whipple Equipment Company, Inc.?

A. Yes, sir.

Q. And also from Whipple Construction Company, Inc.?

A. Yes, sir.

Q. Now, what was Whipple Construction Company, Inc.?

A. Sir?

Q. What was Whipple Construction Company, Inc.?

A. That was a residential construction company.

Q. And what about Dozier-Whipple Construction Company?

A. That was the same thing, sir.

Q. Now, I see a new item here in which the Brag Club, Inc. paid you interest in the amount of $53.07. What was the Brag Club?

A. That was a private club in the 4400 block on Fannin Street up over a restaurant I owned.

Q. Did you own the Brag Club or—

A. That was a corporation. I couldn't own any stock in it, not any part of it.

Q. At the time you received this $53.07 interest from the Brag Club, you owned no interest in the corporation?

A. No, sir.

Q. You were strictly lending money to the company?

A. Yes, sir.

[fol. 141] Q. Well now, you say that you owned a restaurant that was beneath the Brag Club?

A. Yes, sir.
Q. What was the name of that restaurant?
A. Cousin's Restaurant.
Q. And when did you acquire that restaurant?
A. I believe in the latter part of 1951 or the first part of 1952. I believe it was the latter part of 1951.
Q. How long did you operate the restaurant?
A. Until May 31, 1953.
Q. Did you operate that as a corporation?
A. Operated it as an individual.

Mr. Schleider: Would you mark this for identification, please, sir.
The Clerk: Exhibit 22 for identification.

(Whereupon the document was marked for identification as Petitioner's Exhibit 22.)

By Mr. Schleider:

Q. Mr. Whipple, this is the Petitioner's Exhibit 22 which has been marked for identification by the clerk. What is that little article there?
A. It pertains to a restaurant in the 4000 Block on Fannin Street.
Q. And was that your restaurant?
A. That is the restaurant that I had, sir.
Q. What is that article from, Petitioner's Exhibit 22?
A. It's from the Houston Homebuilders Monthly Magazine.
Q. Where did I get this?
A. I don't recall where it came from.
[fol. 142] Q. Did you recognize that as part of your scrapbook by chance?
A. Oh, oh, yes. I believe it came out of it probably.

Mr. Schleider: We offer this, Petitioner's Exhibit 22. I understand Respondent has no objection.
Mr. Bergeron: No objection, Your Honor.
The Court: It will be received and marked in evidence.

(Whereupon the document marked Petitioner's Exhibit 22 for identification was received.)

By Mr. Schleider:

Q. Was Cousin's Restaurant known at any time by any thing other than Cousins.

A. It was originally Biil McKinney's. I mean, when it was first reopened. It was bought as a—the original operation of the restaurant folded, and I bought the equipment.

Q. Now, on the income from rents schedule to your 1952 tax return, Exhibit 13-M, you have listed a rent house, a commercial building in Lubbock. What does that have reference to, the rent house, first?

A. That house is located in Houston on Nottingham.

Q. And you were renting that house at the time, is that right?

A. At that time.

Q. What about the commercial building in Lubbock, what does that have reference to?

[fol. 143] A. That is the building that houses Mission Orange Bottling Company.

Q. In addition to that, I also notice a rental income listed on your 1952 income tax return that describes a building and warehouses, Houston. What particular installation does that have reference to?

A. Well, the Houston property is at 2436 Bissonnet where the Whipple Lumber Company is.

Q. In other words, that has reference to your rental income from the business property occupied by the lumber company?

A. Yes, sir.

Q. Mr. Whipple, I see here on your interest income schedule in your 1952, and I think also in the 1951 tax return, mention of one D. M. Dozier as having paid you some interest. Who was D. M. Dozier?

A. D. M. Dozier was a field superintendent on a construction job that I made a deal with in 1951. At that time he was outside inspector for Federal Housing Administration, and I made a proposition with him and brought him in on a salary and expenses and a percentage of the profits.

Q. Now, when you say percentage of the profits, was there a specific percentage?

A. Fifteen per cent on the over-all on each project that we had.

Q. Well now, you say over-all project. What do you have reference to, fifteen per cent of the over-all project?

A. Well, he had stock in corporations and an interest in the partnerships and an interest in the land deals; in fact anything with the exception, I believe, of Whipple Lumber Company, which the stock had all been bought. He participated in all of that.

Q. All right, sir.

[fol. 144] Now, you said he had a fifteen percent of the profits. What do you mean, that he had fifteen per cent of the corporation and partnership profits or just what did the fifteen per cent apply to?

A. The fifteen per cent of the profits of each partnership and corporation, because I believe that he was a stockholder for that amount in the corporations that were formed later, as long as he was with us.

Q. Well, let's be specific. Suppose a corporation in which Mr. Dozier had an interest, made a profit for, say, let's say the year 1952. Did Mr. Dozier get fifteen per cent of the corporation profits?

A. No, he didn't get fifteen per cent of the—if he had fifteen per cent of the stock in it. I believe you will find that he had stock in the construction corporations that we had.

Q. Well, did his fifteen per cent interest, my specific question is, apply to all of the enterprises and ventures in which you were engaged or entered after Mr. Dozier came with you?

A. Yes.

Q. They did?

A. Yes, sir.

Q. And did that include corporations and partnerships that—and individual enterprises?

A. He had a fifteen per cent interest in all the joint ventures, partnerships, and individual land deals that I had, I gave him a percentage of the profit, I mean, our deal was that he was to get fifteen per cent of the profits of the deal.

Q. That was kind of across the board arrangement?

A. Yes, sir.

Q. All right, sir.

Now, how long did your association with Mr. Dozier continue?

A. I think Mr. Dozier left in February 1953.

[fol. 145] Q. And at the time Mr. Dozier left, did you have a settlement with him?

A. Yes, sir.

Q. And on what basis did you settle with Mr. Dozier?

A. On the basis of fifteen per cent of the profits and estimated there was profits up to that time, and we tried to estimate profits I believe on what we had under construction at that time. And at that time we had the Westheimer land for sale which we had bought a year earlier or two years earlier, and it had increased in value at that time. And when he left, we paid him an estimated profit on that. This money was paid on February 1953, I believe.

Q. Now, let's see if I understand what you have said.

At the time Mr. Dozier left, sometime in 1953, you paid him fifteen per cent of the profits on the various enterprises?

A. Right.

Q. Joint ventures?

A. Yes, sir.

Q. Partnerships, corporations, your individual deals in which he had an interest, based either on actual profits or on profits which were anticipated from particular ventures then pending?

A. That's right.

Q. All right, sir.

Now, you mentioned the Westheimer land. And on your 1953 tax return you deducted the sum of $3,349.50. And deducted that as an ordinary business expense for payments to Mr. Dozier.

Now, was that the sum that you paid Mr. Dozier in early 1953 settling his interest in the Westheimer land?

A. Sir?

[fol. 146] Mr. Schleider: Would you read the question to him, please ma'am.

(Question read.)

A. If that is the figures in the records, that is what he got.

By Mr. Schleider:

Q. That is the one that we have stipulated that you deducted as an ordinary business expense in your 1953 tax return for payment to Mr. Dozier?

A. Yes, sir.

Q. And my question now is: As to that $3,349.50 that you paid in settlement, that represented what, Mr. Dozier's interest in the properties?

A. Yes, sir.

Q. All right.

Now, was that paid in connection with any work that he did on the Westheimer land or—

A. No, sir. He didn't do any work. It was a piece of land and it had laid out for a year and a half.

Q. On what did you base—

A. On the over-all fifteen per cent of the profits.

Q. Well, at that time, and I refer to the time that you settled with Mr. Dozier, you had not earned any profits from the Westheimer land.

A. That was anticipated profits. The land had gone up in value and that was in the over-all settlement.

Q. Then in effect that would just be a payment in the form of compensation to Mr. Dozier?

A. Yes, sir.

Q. That was a part of his over-all compensation?

A. Yes, sir.

Q. How much did you pay Mr. Dozier in settlement in early 1953, approximately?

[fol. 147] A. Approximately $29,000, I believe.

Q. Now, of course, I take it that there were some credits and offsets.

A. Yes, sir,

Q. Did those sums come from you individually or—

A. Part of them did, I think some several eight or ten checks, different partnerships and corporations paid it.

Q. Now, in 1952 I notice there is attached to your tax return a form 1099, which is labeled Joint Exhibit 13-M,

and it indicates that there was $1,250 paid to you by Federated Department Stores, Inc. of Cincinnati, Ohio. What did the sum represent?

A. Well, that year, that was in connection with the purchase of some land for Mr. Lazarus for Foley's. Mr. Dillingham came to me, and there was a piece of land that joined some property they were going to erect a warehouse on, and they had five days before they were going to start construction. They wanted this property; they wanted to buy it. But with people like that, the price would have probably been much higher than someone else, and I bought the property for them within their budget; and that was the compensation for making the deal for Mr. Lazarus of Foleys.

Q. I am now referring to Joint Exhibit 20-T, which is your 1953 income tax return. In your interest income schedule I notice that you have reported income from interest paid you by Whipple Equipment Company, the Brag Club, Guy Francis and also says: "Guy's Restaurant," and Whipple Lumber Company. Now, what was Guy's Restaurant?

A. Well, Guy Francis is a man to whom I sold Cousin's Restaurant May 31, 1953.

Q. And the Brag Club is the Brag Club that you previously talked about?

A. Over the restaurant.

[fol. 148] Q. And in 1953, you had no interest in that club at that time?

A. No, sir.

Q. Neither 1952 nor 1953?

A. No, sir.

Q. Did you ever own an interest in the Brag Club?

A. No, sir.

Q. Now, I see here in the schedule listing your salaries, Chevy Chase Development Corporation from which you reported a salary. What was Chevy Chase Development Corporation?

A. It was a construction company.

Q. And did you own an interest in that corporation?

A. Yes, sir.

Q. Now, I am again—this line of questioning that I am asking you now pertains to your 1953 income tax return which I previously discussed with you.

I also note in there you also received a salary from Angleton Homes Corporation. Did you own an interest in that corporation?

A. Yes, sir.

Q. And Whipple Equipment Company.

A. Yes, sir.

Q. You owned an interest in that, did you?

A. Yes, sir.

Q. And Whipple Construction Company, Inc., is that correct?

A. Yes, sir.

Q. You owned also or reported a salary from Dozier Whipple Construction Corporation.

A. Yes, sir.

Q. You owned an interest in that?

A. Yes, sir.

Q. You owned that interest in 1952 and 1953?

A. Yes, sir. Now, I—

[fol. 149] Q. I see here listed in your income tax from business partnerships, which is your schedule C, income which you report from A. J. Whipple Construction Company No. 2. Now, what was A. J. Whipple Construction Company No. 2?

A. That was a partnership, construction partnership that was formed after D. M. Dozier came into the picture.

Q. And I also see in that schedule C that you report a loss from Cousin's Restaurant, is that correct? You were operating it part of the time in 1953, Cousin's Restaurant?

A. Yes, sir.

Q. Now, in the schedule of income from other sources, which is Schedule—excuse me—income from rents, you list for the year 1953 building and warehouse Houston, frame house, Houston, commercial building, Lubbock. Are those the same items of property which you were renting and for which you reported income for 1952; is that correct?

A. Yes, sir.

Q. In other words, the building and warehouse would be the lumber yard site?

A. Yes, sir.

Q. And the frame house would be your rent house?

A. Yes, sir.

Q. And the commercial building at Lubbock would be the bottling plant, is that correct?

A. Yes, sir.

Q. Mr. Whipple, in schedule D of your 1953 tax return, which deals with the gain or loss on the sale of capital assets, I see listed here Mason's Rootbeer stock as being sold in 1953, shows an acquisition date of September 1, 1951.

Now, what was Mason's Rootbeer stock?

[fol. 150] A. Mason's Rootbeer was a soft drink bottling venture in Amarillo, Texas.

Q. You say soft drink bottling venture in Amarillo, Texas. Whose venture was it?

A. Mine.

Q. And did you form Mason's Rootbeer?

A. It was a corporation we formed.

Q. Were you an original incorporator and stockholder?

A. Yes, sir.

Q. Who owned th principal stock in Mason's Rootbeer stock?

A. I did.

Q. Do you recall about how much stock you owned in Mason's Rootbeer?

A. If I remember correctly, it was a 10,000 corporation, that is, $10,000 corporation, with $5,000 paid up, of which I owned, I believe, $3,800 out of the $5,000 that was paid in originally.

Q. And tell me a little bit about the kind of business Mason's Rootbeer was engaged in?

A. They were distributors of franchised drinks in Amarillo which we bottled in our plant in Lubbock and hauled by transport to Amarillo.

Q. Was that bottled under the franchises held in the Lubbock plant?

A. No. It was separate franchises for the Amarillo territory.

Q. Did you have the franchise in your name or was it in the name of Mason's Rootbeer?

A. The franchise for Lubbock was in my name as an individual. I am not positive about Amarillo. I just don't recall. But I know they were separate franchises.

Q. Was any bottling done at all in Amarillo, Texas?

A. No, sir.

[fol. 151] Q. That was strictly a distributing company, is that correct?

A. Yes, sir.

Q. And to whom did you sell the Mason's Rootbeer stock, do you recall?

A. It wasn't sold.

Q. The corporation—what happened to the corporation?

A. Sir?

Q. What happened?

A. Mason's Rootbeer?

Q. Yes, sir.

A. It was folded.

Q. Now, you also took a deduction in 1953 for Mission Orange Bottling Company, Inc. of Lubbock, Texas.

A. Yes, sir.

Q. What was Mission Orange Bottling Company, Inc. of Lubbock, Texas?

A. It was a corporation that manufactured and sold franchised soft beverages.

Q. Under what franchise was the manufacturing and selling done?

A. Under Mission Dry Corporation out of California, Delaware Punch Corporation out of San Antonio.

Q. Were those franchises in your name as an individual?

A. They were in the name of A. J. Whipple.

Q. When did you first go into the bottling business at Lubbock, what date?

A. April, 1951.

Q. And did you acquire the bottling plant in Lubbock?

A. I bought it from D. C. Casey of Lubbock.

Q. Had Mission Orange, the corporation, been formed at that time by you?

A. No, sir.

[fol. 152] Q. You bought the plant from Casey in your individual capacity, is that right?

A. Yes, sir.

Q. Did you operate that plant in your individual capacity?

A. I believe for some six months.

Q. Is that right?

A. Yes, sir.

Q. All right.

A. And—

Q. How long after you acquired the bottling plant in Lubbock that Mission Orange, the corporation, was formed?

A. I think approximately six months after we—

Q. I think the record will show, and we have so stipulated, that the corporation was formed on June 8.

A. Well, I don't recall.

Q. And now, you are testifying only from your recollection; is that right?

A. Yes, sir.

Q. There was some period of time in which you operated Mission Orange as a sole proprietorship; is that right?

A. Yes, sir.

Q. You are not distinct about the time involved; am I correct?

A. That's right.

Q. Now, how did you distribute other than through Mason's Rootbeer and the Mission Orange Bottling plant of Lubbock, how did you distribute the soft drinks that were manufactured in Lubbock? Did you use route trucks?

A. Route trucks that serviced the trade.

Q. I suppose that you sold syrup and things of that sort to various restaurants and drug stores?

A. Some, yes.

[fol. 153] Q. How about vending machines, did you have any vending machines?

A. We had a vending machine set up with Ideal, Indiana, where we hold vending machines to the trade.

Q. Well now, did Mission Orange, the corporation, own any interest in the vending machines operation?

A. No, sir.

Q. That was something separate and apart?

A. Yes, sir.

Q. Did you have a local manager on the ground, so to speak, at Lubbock when you first started Mission Orange?

A. Yes, sir.

Q. Who was he?

A. James A. Finley.

Q. And how long did Mr. Finley stay in your employ?

A. From the time of purchase, I believe, August 1953; April 1951 to August 1953.

Q. In other words, if you acquired the Mission Orange franchise and the equipment and bottling plant in your individual capacity in late April, 1951, would Mr. Finley have been operating directly for you at Lubbock while you were operating as a sole proprietor?

A. Yes, sir, he went there when I bought the plant.

Q. In other words, for a time Mr. Finley was directly employed by you?

A. Yes, sir.

Q. And then after Mission Orange Corporation was formed, I take it he was employed by Mission Orange, is that right?

A. Yes, sir, Mr. Finley, yes, sir.

Q. Now—

A. That was—when Mr. Finley first went there, I made Mr. Finley several cash loans. But I don't believe he ever appeared on my permanent books on a salary.

[fol. 154] Q. I see.

Where was Mission Orange doing its bottling when you first acquired the plant in 1951?

A. 2518 Avenue H in Lubbock.

Q. Did they continue at all times to occupy that property?

A. They occupied it until, up until we completed a new plant on the opposite side of the city.

Q. Who built that plant?

A. I did.

Q. You say "I". You mean in your individual capacity?

A. Yes, sir. It belongs to me.

Q. The legal title is vested in you?

A. Yes.

Q. You actually have a deed to the property?

A. Yes, sir.
Q. It's to A. J. Whipple?
A. Yes, sir.
Q. It's not to any corporation?
A. No, sir.
Q. And how about the building, who constructed that?
A. It was constructed for me by a contractor in Lubbock.
Q. But I mean the actual payment of the cost of erecting the structure was borne by you as an individual?
A. Yes, sir.
Q. Not by some corporation?
A. No, sir.
Q. By you as an individual?
A. Yes, sir.
Q. That is the plant you have listed in your 1952 and 1953 tax returns, is that right?
A. Yes, sir.
[fol. 155] Q. That is what you call the commercial building, Lubbock?
A. Yes, sir.
Q. Did you have a lease with Mission Orange on that property?
A. Yes, sir, I did.
Q. Well, I thought I said "did."
A. Well, I thought you said do I.
Q. No.
Mission Orange I take it continued to occupy the premises that you had constructed?
A. Yes, sir.
Q. At all times after it was built, during 1952 and 1953, is that right?
A. Yes, sir.
Q. What prompted you—

Mr. Schleider: Would you mark this as exhibit—
The Clerk: 23 for identification.

(Whereupon the document was marked for identification as Petitioner's Exhibit 23.)

Mr. Schleider: And mark Exhibit 24 for identification.
The Clerk: 24 for identification.

(Whereupon the document was marked for identification as Petitioner's Exhibit 24.)

[fol. 156] By Mr. Schleider:

Q. Mr. Whipple, I have here what has been marked as Petitioner's Exhibits 23 and 24, respectively, which appear to be letters, one dated October 14, 1952, which is Exhibit 24, and one dated June 28, 1953.

Exhibit 24 is a carbon copy, and so is Exhibit 23, and can you tell me who wrote and signed the originals and to whom they were sent?

A. They are letters I wrote to Mr. Finley in Lubbock.

Q. Do you have the original letters?

A. The originals?

Q. Yes.

A. They were sent to Mr. Finley.

Q. Are these copies of those letters?

A. Yes, sir.

Q. And what were they sent to Mr. Finley for?

A. Well, concerning the operation of Mission Orange Bottling Company in Lubbock. And his duties there.

Q. All right, sir.

Did you have any difficulty with Mr. Finley in connection with the managing of those, of the plant?

A. Quite a bit.

Q. What were some of the big problems you had?

A. Finding him when I wanted him. I couldn't keep him on the job.

Q. Did you ever require that he report to you?

A. I tried to, sir.

Q. What kind of report did you require?

A. Sir?

Q. What kind of reports did you require of Mr. Finley?

A. Well, I got a daily report—you mean—I had a daily report from the plant, but as far as Mr. Finley was concerned, I had to go—

Q. I notice—excuse me; I didn't mean to interrupt you.

[fol. 157] A. I had to go to Lubbock quite often and kept in touch with him by telephone.

Q. Now, in these two letters marked respectively as Petitioner's Exhibits 23 and 24, you refer to some reports and daily balance sheets for sales figures and the like.

A. Yes, sir.

Q. And expecting one every 24 hours. Are these reports referred to in Exhibits 23 and 24 the daily reports that you required?

A. Yes, sir.

Mr. Schleider: I am going to offer these.

Mr. Bergeron: No objection.

The Court: It will be received and marked in evidence.

(Whereupon the documents marked Petitioner's Exhibits 23 and 24 for identification were received.)

By Mr. Schleider:

Q. Mr. Whipple, it's the truth, is it not, that part of the problem with Mr. Finley was that he wasn't advising you properly, daily, of the operations of the plant; isn't that correct?

A. That's right.

Q. And why did you require these reports every 24 hours?

A. To try to keep a check on it.

Q. As part of your control of the business?

A. Yes, sir.

Q. Did you make any trips up to Lubbock during the period that you owned Mission Orange? And I am talking [fol. 158] now specifically about the years 1951, 1952 and 1953.

A. I spent a lot of time up there.

Q. Could you give me approximately how much time you did spend up there, or how many trips you made? I know you can't be exact. But approximately how many trips did you make up there during that interval of time?

A. During that two-year period?

Q. Yes, sir.

A. I would say thirty-five or forty.

Q. And did you make long distance telephone calls up there?

A. Numerous, yes, sir.

Q. Did your have frequent telephone conversations with Mr. Finley?

A. Sir?

Q. Did you have frequent telephone conversations with Mr. Finley?

A. Yes, sir.

Q. Now, did Mr. Finley ever come down here to Hous on and talk with you?

A. Yes, sir, several times.

Q. And in addition to the trips you made to Lubbock, Finley would come down here, is that right?

A. Yes, sir.

Q. What would be the purpose of his trips down here and your trips up there?

A. It would be a matter of talking about what was going on up there, discussing the Mission Orange deal.

Q. Who made the managerial decisions as to the policies and prescribed the business practices that would be followed?

A. I tried to.

Q. In so far as Mission Orange was concerned.

A. Yes, sir.

[fol. 159] Q. Now, in 1953 I think you said Mr. Finley—his employment was terminated with Mission Orange.

A. Yes, sir.

Q. That was done at your request?

A. Yes, sir.

Q. Now, did you have a general plant manager after Finley was discharged?

A. I had a plant superintendent.

Q. But I mean—

A. Not an overall manager.

Q. Who did the managing after Finley left?

A. I did at that time.

Q. And did you continue to manage the plant for the remainder of 1953?

A. Yes, sir.

Q. During 1953 and 1952, who owned the Mission Orange franchise?

A. Yes, sir.

Q. I say who owned the Mission Orange franchise?

A. Oh, I did, sir.

Q. And who was the president of Mission Orange?

A. Sir?

Q. Who was the president of Mission Orange?

A. I was.

Q. How long were you the president? Were you president in 1952?

A. Yes, sir.

Q. Were you president in 1953?

A. Yes, sir.

Q. You were the chief executive officer of the company, is that right?

A. Yes, sir.

Q. And you also were the principal stockholder in the company?

A. Yes, sir.

[fol. 160] Q. Does the date December 13, 1953 have any significance to you insofar as Mission Orange is concerned? Well, I think I am at liberty to refer to the stipulation. We have stipulated here about a bill of sale you acquired, whereby you acquired certain personal property of Mission Orange on December 15, 1953.

A. Yes, sir.

Q. Is that correct?

A. Yes, sir.

Q. What equipment and personal property did you acquire? I know that the bill of sale has a detailed list, but in general, what did you acquire?

A. The equipment that constitutes the bottling plant, with the exception of, I would say there were three pieces of equipment at that time that I believe were mortgaged, of which I didn't take title to. They were mortgaged to Mission Dry Corporation.

Q. But generally, you acquired all of the equipment that was necessary to operate a bottling plant; is that right?

A. Yes, sir.

Q. And from December 15, 1953 on, you owned that equipment?

A. Yes, sir.

The Court: We will take a ten-minute recess.

(Recess.)

By Mr. Schleider:

Q. Mr. Whipple, did you guarantee any loans made to Mission Orange in 1953?

A. Yes, sir.

Q. Do you recall any of those loans that were guaranteed by you?

[fol. 161] A. Well, I guaranteed all the loans at the bank, and I guaranteed accounts with some of the major sources of supply, which would be Delaware Punch, Mission Orange, Anchor Cork and Glass, Liberty Glass, Owens Glass, Brockway Glass.

Q. Now, let me ask you another question here, and that is, did you, during 1953, make a substantial loan or loans to any other corporation other than Mission Orange?

A. I handled some Angelton Building and Holding Company in Angelton.

Q. And that was one of the corporations I believe you had an interest in, is that right?

A. Yes, sir.

Q. Could you tell me approximately how much you loaned to Angelton Building and Holding Corporation in 1953, approximately?

A. I would say some $25,000 or $30,000.

Q. Now then, is it a fair summary that you continued in 1953 to carry on the same type of business and operations that you had done in 1953 and 1951—in 1952 and 1951?

A. Yes, sir.

Mr. Schleider: I have no further questions, Your Honor. Pass the witness.

Cross examination.

By Mr. Bergeron:

Q. Would you say, Mr. Whipple, that your main occupation is building construction?

A. My main occupation? It has been.

Q. Since 1941 when you went with Strickland, that has been your main occupation, has been the development of [fol. 162] property and the building of homes and apartment houses, has it not?

A. I would say I spent the greater part of my time doing it.

Q. Now, you said that there was a Brag Club connected with your Cousin's Restaurant which you could not be—

A. It wasn't connected with the restaurant.

Q. What was the Brag Club?

A. It's a private club up over a restaurant.

Q. Over a restaurant.

And you owned the restaurant?

A. I did own it, yes, sir.

Q. And was that not a drinking club?

A. A drinking club.

Q. In other words, in connection with—well, in Texas, you can't buy drinks by the drink in a restaurant or a bar?

A. That's right.

Q. So the Brag Club complied with the laws of Texas insofar as serving liquor is concerned, is that so?

A. Well, that was a separate—

Q. In other words, you allocated part of your property for the purpose of that club?

A. That was a separate operation entirely. It was two different entities, one for the upstairs and one for the downstairs.

Q. In other words, you had nothing to do with the upstairs?

A. No, sir.

Q. And that Brag Club was there when you bought Cousin's, is that it?

A. No, sir, it wasn't open.

Q. But it was opened as a result of your opening the restaurant?

A. Yes, sir.

[fol. 163] Q. You stated that after you took over the equipment of Mission Orange on December 15, 1953, that it only left a few pieces of equipment in the corporation, is that true, was that the gist of your testimony?

A. Yes, sir.

Q. Do you know what kind of equipment was left?

A. If I am correct, sir, it was a filler and saturater and a mixer.

Q. Is that all the equipment that was left in the corporation, I mean?

A. That's what I think.

Q. You were president of that Mission Orange Bottling Company of Lubbock, Inc., were you not?

A. Yes, sir.

Q. You were president from the date of its organization on June 8, 1951, is that true?

A. Yes, sir.

Q. To refresh your memory, I show you the return of the corporation, Form 1120, for the fiscal year 1954, and ask you if that is your signature at the bottom of the page.

Mr. Schleider: Your Honor, I object to this. Now, this is a 1954 return of Mission Orange—am I correct?

Mr. Bergeron: Fiscal year ended May 1954, which included December 31, 1953, on which date—the date on which the transfer of assets were made and which Mr. Whipple stated he left very few assets to the corporation.

The Court: It doesn't include a part of the present year? [fol. 164] Mr. Schleider: I object to it unless there is some materiality shown, because I see no materialify to this line of questioning here, and particularly in view of the fact he is using a 1954 return.

The Court: But there is no magic in that 1954 business. It's for the month—

Mr. Bergeron: December 31, 1953.

The Court: What is the fiscal year?

Mr. Bergeron: Ending May 31, 1954.

The Court: For the months of May to December, 1953, which is the period we have before us.

Mr. Schleider: I think any reference to that return should be limited in its consideration to that particular period.

The Court: We haven't gotten there yet. All he has asked is: Is it his signature. I will overrule the objection.

By Mr. Bergeron:

Q. Is that your signature?

A. Yes.

Q. This is a schedule marked Schedule L, depreciation schedule, and I will ask you to look it over.

[fol. 165] Does that show the equipment before and after the transfer of equipment to you on or about December 15, 1953?

A. If I am correct, is this the figures that you—

Q. No. These here, these are your assets at the beginning and ending of the fiscal year?

A. Yes, sir.

Q. In other words, what was the figure at the beginning of the fiscal year or on January—on June 1, 1953, what was the total amount?

A. $105,655.85.

Q. And what was the amount as of the end of the fiscal year or May 31, 1954?

Mr. Schleider: I object Your Honor. That has no materiality here.

The Court: Why?

Mr. Bergeron: I want to show the deduction and how much was left. He said there was very little assets left of the equipment after he took the properties on December 15, 1953. I want to show there was over $20,000 of equipment left in the corporation after the transfer to Mr. Whipple.

The Court: In other words, you are not really interested in May; you are interested in January 31. There isn't any way for you to find out.

The Witness: Let me ask you a question.

[fol. 166] Mr. Schleider: Wait just a minute, Mr. Whipple.

Your Honor, again, I renew my objection. It's an attempt to evade our express stipulation that this is a bad debt question, and this has no materiality whatsoever.

The question, it's been stipulated expressly, that the only issue before the Court is business bad debt or not business bad debt.

The Court: Well now, Mr. Bergeron, is there any question here of the credibility of the witness or possibly casting down on the accuracy of his statement?

Mr. Bergeron: That there were very little assets left after he took the remaining.

The Court: You are not producing this for the purpose of qualifying anything that was said—

Mr. Bergeron: No, sir. The stipulation is still a hundred per cent as stated. The evidence is that there were hardly any assets left after he took—

The Court? I think that is a legitimate line of questioning.

Mr. Schleider: Is it offered for impeachment purposes?

The Court: That is my understanding.

[fol. 167] Mr. Schleider: I object there because there is no proper predicate laid for impeachment because the witness testified the books would reflect that, and that would be the best evidence.

The Court: My recollection is the same as Mr. Bergeron, that there was practically nothing left. He said that, regardless of what is in the bill of sale. If the transcript doesn't show that, we have no grounds for impeachment and you aren't hurt.

Mr. Schleider: It's arguendo and—

The Court: It's obviously a statement he made and you have the witness on the stand and you can show it was incorrect.

Mr. Schleider: Is it solely for impeachment purposes?

The Court: That is what I understood.

You may answer.

You want to have the question put again?

Mr. Bergeron: Would you repeat the question.

(Question read.)

A. $22,868.38 represents the end of the fiscal year, and not plant equipment.

[fol. 168] Q. The plant equipment was gone, but you had in this truck and the office equipment, the containers and coolers to the extent of $2,272.25?

A. Yes, sir.

Q. And leasehold, or a total of $22,868.38 as of the end of the year; is that true?

A. Yes, sir.

Q. And that was after you had taken over the $63,000 worth of plant and equipment, is that true?

A. Yes, sir.

Q. And also disposed of $22,000 of the old truck equipment?

A. Yes, sir.

Mr. Schleider: I move to strike the testimony on the grounds that it's not material, Your Honor.

The Court: Well, I will take the motion under advisement, and the way you will know how I have decided it is whether or not it's employed in respect to my final conclusion.

It still is just a question of argument. Mr. Bergeron may argue from the transcript this is inconsistent to what the witness testified before and, therefor, he has tended to impeach his credibility. And whether he can or not will depend on what the transcript shows.

Mr. Bergeron: One more question.

By Mr. Bergeron:

Q. Mr. Whipple, you stated that as to the Angelton Corporation you had made a loan of $25,000 in 1953; is that true?

[fol. 169] A. I said approximately. I didn't—

Q. In other words, that was one of your construction companies too, wasn't it, that Angelton—

A. Yes, sir.

Q. What was the name, Angelton Homes Corporation was the name of it?

A. Angelton Building and Holding Corporation.

Q. And you were one of the owners of the property of, of the corporation?

A. Yes, sir.

Mr. Bergeron: That's all.

Redirect examination.

By Mr. Schleider:

Q. Mr. Whipple, in your testimony on direct examination in response to my question with reference to transfer of certain property by Mission Orange, the corporation, to you in December of 1953, you had reference I believe you said to the bottling equipment.

A. Yes, sir.

Q. That was all you had reference to?

A. Yes, sir.

Mr. Schleider: No further questions.

Mr. Bergeron: I am through with him.

The Court: Well, before this witness leaves the stand—and this is not a question I want to ask the witness; it may really come down to a matter that I will expect you to [fol. 170] deal with in your brief. But primarily, the result of being in a business is the creation of ordinary income? It may be through salaries or it may be through the purchase and sale of property.

When as a result of a business it's the acquisition, properties acquisition in connection with the business, there is a sale, there is normally an ordinary gain and loss and not a capital. I don't imagine there would be anything further you want to ask this witness, but I gathered the impression that when the property was sold to which you referred that he acquired around 1949, 1950, and so on, that it was treated as capital gain, whereas, in the case of a true promoter, he makes his money either by being hired to do the promoting by some syndicate or other, from which he gets a salary and, therefore, the tax is ordinary income; or he makes his money by buying into interests and trying to sell them at a profit, in which case he would do so at ordinary income rates.

I want to give you that phase of the question I am asking you so if there is anything further you want to ask this witness you can develop it.

I am correct, am I not, that this was treated as capital gains?

Mr. Schleider: I would have to check to see that, Your Honor.

The Court: I think you asked the question of the witness, that he had reported the sale of these various properties, I think it was in 1951 interests in partnerships and stock of corporations, and so on, as capital gains.

Mr. Schleider: Those stocks in the 1951 return, as to the capital gain schedule—

[fol. 171] Mr. Bergeron: 12-L.

The Court: Yes, they include such as 29th and Air Line, Inc., and Industrial Homes, Air Line Lumber, a lot of which were—Strickland-Whipple Construction Company, a lot of which were developed, as I understood it, to indicate how many different enterprises this Petitioner had been connected with.

Mr. Schleider: Yes, sir.

The Court: And they were, when they were disposed of, they were all treated as capital gain, as I understand.

Mr. Schleider: That's correct.

The Court: So I want to give you that thought—

Mr. Schleider: Would the Court indulge us in just a brief conference here with co-counsel?

The Court: Yes.

Mr. Schleider: If it please the Court, I believe we have nothing further to add on that score.

[fol. 172] The Court: Very well.

Mr. Dillingham: We appreciate that though, Your Honor.

The Court: Anything for the Respondent?

Mr. Bergeron: We are through.

The Court: What about briefs?

Mr. Schleider: If it please the Court, we would like ninety days on our brief, original brief, plus thirty days for the replies.

Mr. Bergeron: That throws us into the summer vacation. Let's take sixty days. I don't want to write a brief in July. It's too hot.

The Court: Of course, there is nothing to stop you from getting your first brief in within the sixty days.

Mr. Bergeron: But I will be worried. I won't know what he is going to say in his if he has thirty days more.

The Court: Let's see how it works out. I would rather take the time now than for you to come in for an extension, which happens all the time.

[fol. 173] Mr. Bergeron: I never ask for an extension. You know it.

The Court: The ninety days would be when, Mr. Clerk?

The Clerk: July 22.

The Court: And sixty days would be when?

The Clerk: Sixty days would be June 22.

The Court: And then if it were ninety days—and what did you ask for, thirty days for reply?

Mr. Bergeron: Yes, sir.

But I wasn't trying to speak for him. He is the principal for that.

The Court: If it were forty five days for reply, that would give you time to go into the fall for the reply brief. Would that be satisfactory?

Mr. Bergeron: O.K.

The Court: All right.

[fol. 174] Ninety days for the main brief and forty five days for the reply.

The Clerk: July 22 for the original brief—July 21 for the original brief and September 4, 1959, for replies.

Mr. Schleider: July 21, 1959 for—

The Clerk: Original briefs.

And September 4, 1959, for the reply briefs.

The Clerk: Anything further?

Mr. Bergeron: No, nothing further, Your Honor.

Mr. Schleider: Nothing further.

The Court: Mark submitted.

Mr. Schleider: I said nothing further. I believe under the stipulation yesterday it was allowed by the Court that I could reproduce this, send Mr. Bergeron a copy and send the original withdrawn to the clerk.

The Court: Whatever exhibits you want to take out.

[fol. 175] Mr. Schleider: I don't need to file a written motion on that, do I?

The Court: No, but leave a receipt with the clerk.

Can you do that in the back of the room so we can go ahead with the next case.

Mr. Schleider: All right, sir.

(Whereupon, at 11:50 o'clock, a.m., the hearing in the above-entitled matter was concluded.)

BEFORE THE TAX COURT OF THE UNITED STATES

MOTION FOR TRANSMISSION OF TESTIMONY, STIPULATION OF FACTS AND ORIGINAL EXHIBITS—Filed October 7, 1960, and order thereon.

COME Now the parties to the above-entitled proceeding by their counsel of record, and move:

1. That the original official report of proceedings before the Tax Court of the United States at its hearing in Galveston, Texas, on April 21, and 22, 1959, pages 1-32, and the original stipulation of facts, together with the originals of Exhibits 1-A through 20-T attached thereto, and the originals of Petitioners' Exhibits 21, 22, 23 and 24, filed on April 21, and 22, 1959, in lieu of a narrative statement of the evidence, be made a part of the transcript of record in this cause to be filed with this Court, all of said original [fol. 176] documents to be returned to the Tax Court when they have served the purpose of this Court.

2. That the originals of Exhibits 1-A through 20-T attached to the stipulation of facts and the originals of Petitioners' Exhibits 21, 22, 23 and 24, shall remain in the custody of the Tax Court until ten days prior to the hearing before this Court, and upon direction of counsel, to be then transmitted by the Clerk of the Tax Court to this Court.

3. That said Exhibits 1-A through 20-T attached to the stipulation of facts, and Petitioners' Exhibits 21, 22, 23 and 24, need not be printed in the record on review herein but may be referred to by counsel in their respective briefs and on oral argument, or reproduced, in whole or in part, in an appendix to their respective briefs, and considered by the Court with same force and effect as if included in the printed record on review.

4. That the Clerk of this Court transmit a certified copy of this Order to the Clerk of the Tax Court of the United States to be by him incorporated in the transcript of record on review herein.

Charles Dillingham, Counsel for Petitioners on Review, 802 Texas National Bank Bldg., Houston 2, Texas.

Charles K. Rice, CRM, Assistant Attorney General.

[fol. 177] Hart H. Spiegel, CRM, Chief Counsel, Internal Revenue Service, Counsel for Respondent on Review.

So Ordered: Richard T. Rives, U. S. Circuit Judge.

BEFORE THE TAX COURT OF THE UNITED STATES

PRAECIPE FOR RECORD—Filed February 17, 1961

To the Clerk of the Tax Court of the United States:

You will please transmit and deliver to the Clerk of the United States Court of Appeals for the Fifth Circuit, copies, duly certified as correct, and originals where so designated, of the following documents and in the above-entitled cause, in connection with the petition for review by the said Court of Appeals for the Fifth Circuit, heretofore filed by the above-named petitioner.

1. Docket entries of the proceedings before the Tax Court of the United States.

2. Pleadings before that Court.

3. Findings of fact, opinion and decision of that Court.

4. Petition for review and assignments of error.

[fol. 178] 5. Original of the full official report of proceedings before the Tax Court of the United States at its hearings in Galveston, Texas, on April 21 and 22, 1959, pages 1-132.

6. The original Stipulation of Facts.

7. Originals of Exhibits 1-A through 20-T attached to the Stipulation of Facts.

8. Originals of Petitioner's Exhibits 21, 22, 23 and 24 filed with the Tax Court on April 21 and 22, 1959.

9. This praecipe.

10. Motion for transmission of testimony, stipulation of facts and original exhibits.

11. Order for transmission of testimony, stipulation of facts and original exhibits.

12. Notice of filing petition for review.

13. Orders enlarging time for transmission and delivery of record.

Charles Dillingham, Ben H. Schleider, Jr., Attorneys for Petitioners on Review.

Charles Dillingham, Ben H. Schleider, Jr., 802 Texas National Bank Bldg., Houston 2, Texas.

[fol. 179] Certificate of service (omitted in printing).

[fol. 180] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 181]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 18963

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—
November 8, 1961

[Title omitted]

On this day this cause was called, and after argument by Charles Dillingham, Esquire, for appellants, and William A. Friedlander, Esquire, Attorney, United States Department of Justice, was submitted to the Court.

[fol. 182]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 18963

A. J. WHIPPLE and MILDRED WHIPPLE, Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition for Review of Decision of the Tax Court of the United States.

OPINION—April 4, 1962

Before Tuttle, Chief Judge, Hutcheson and Rives, Circuit Judges.

Tuttle, Chief Judge: The taxpayer-petitioners here complain of the decision of the Tax Court which held that the taxpayers' advances to the corporation, in which the husband held a majority interest, represented, within the meaning of Section 23 (k) of the 1939 Internal Revenue Code, a non-business rather than a business bad debt, when these advances became worthless upon the insolvency of the corporation. So far as is significant here a non-business bad [fol. 183] debt is defined in the statute as one "other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business." The debt which the petitioner claims he should be allowed to deduct as a business bad debt represents the balance of unpaid advances which Whipple had made to Mission Orange Bottling Company, a soft drink bottling company, in which he owned approximately 80% of the stock and of which, at the time of the debt becoming worthless, he had assumed the active man-

agement because of its unsuccessful operation thus far. The final advance of $48,000 was made by taxpayer to Mission Orange coincidentally with its transfer to him of its entire physical assets on December 15, 1953. This left his unrecovered claim against Mission Orange at $56,975.10. It is conceded that this amount became worthless during the month of December, 1953.

The Tax Court, based on ample evidence, found that during the period of four years commencing in 1949, petitioner was instrumental in incorporating fifteen corporations, fourteen of these were engaged in construction, building or real estate business; petitioner owned an interest in five additional construction or real estate corporations, and at one time or another was a member of ten partnerships involved in similar activities; during this period of time the petitioner spent the major part of his time and energies in the construction of real estate business, or the related building supply business; on April 25, 1951, petitioner obtained a franchise from the Mission Dry Corporation entitling him to produce, bottle, distribute and sell Mission Beverages in certain counties in Texas; during the same month he purchased the bottling machinery and equipment then owned by one D. C. Casey, who was operating the Mission Orange [fol. 184] Company in Lubbock, Texas; he conducted this business as a sole proprietorship until approximately July 1, 1951, at which time he organized debtor corporation, Mission Orange Bottling Company, and transferred the bottling machinery and equipment to it; the bottling business was apparently not successful, for during the years 1952 and 1953, he made advances to it so that including the amount which the corporation owed him as the result of his sale of the bottling assets, it was indebted to him in the sum of $79,489.06, on December 1, 1953. On December 15th petitioner advanced Mission Orange $48,000 to pay general creditors, and on the same date he received a transfer from Mission Orange of bottling machinery, equipment and an automobile, which had the value of $70,414.66. This left a net amount due by Mission Orange to him of $56,975.10, which the Tax Court found became worthless during the month of December, 1953.

The Tax Court, in its opinion, stated:

> "If we were required to find a definite time of worthlessness we should be inclined to say December 15, 1953, at which time petitioner received the bottling machinery from Mission Orange in partial satisfaction of that corporation's obligation."

Thus it appears that at the time when the sum of $48,000 of the indebtedness in issue was advanced to Mission Orange petitioner had no hope of its being recovered.

Petitioner recognizes the usual rule that where the controlling stockholder of a corporation is unable to obtain [fol. 185] repayment of moneys he advances to his corporation to bolster up its operating possibilities this is generally considered a non-business bad debt. This follows because in such a case the loan or advance made by the taxpayer to the corporation is no part of any business which he is engaged in individually. It is an advance or loan made by him to enable his wholly owned corporation to make a profit. The petitioner here, however, contends that his extensive activity in the formation of the numerous corporations and the extensive activity he himself performed in attempting to save the Mission Orange Company in its operation, made these particular advances loans in some separate trade or business carried on by the taxpayer.

The Tax Court made the following findings of fact:

> "Petitioner was not in the business of organizing, promoting, managing or financing corporations in 1953. He was not in the business of lending money in that year."

In its opinion the Tax Court also determined that taxpayer was not personally in the business of bottling and selling soft drinks at the time he made the advances that resulted in the debt here in issue.

In the case of *Giblin* v. *Commissioner*, 5 Cir. 227 F. 2d 692, this Court said:

> "We recognize the fact that the question whether the activities of a taxpayer constitute carrying on a trade or business is largely one of fact, the solution of which 'requires an examination of the facts in each case.'

[fol. 186] Higgins v. Commissioner of Internal Revenue, 312 U. S. 212, 217, 61 S. Ct. 475, 478, 85 L. Ed. 783. The findings of the Tax Court or the District Court, therefore, are normally critical on this issue."

The Giblin case is one in which this Court found that under the peculiar circumstances which were there present a taxpayer could treat a loss, resulting from the failure of his wholly or partially owned corporations to repay advances, as a business bad debt. In articulating the circumstances which justified a finding of the existence of a business bad debt, we said:

"Taxpayer did not seek to show that he was engaged in the business of making loans. Neither did he seek to have the Tax Court 'pierce the corporate veil' and find that he was engaged in the restaurant business or in any of the other businesses which he had promoted and dealt with during the preceding twenty years. What he did seek to prove was that he was regularly engaged in the business of seeking out business opportunities, promoting, organizing and financing them, contributing to them substantially 50% of his time and energy and then disposing of them either at a profit or loss . . . "

We further stated:

"Petitioner's right to deduct the amount of the cancelled debt depends not upon his showing, as the Tax Court seemed to think, that he was in the business of lending [fol. 187] money, but rather that he was regularly engaged in the business of 'dealing in enterprises,' during the course of which he operated either as a proprietor, as a stockholder, as a partner or as a lender or in a combination of these capacities, contributing to each enterprise his own initiative and energy, and such financial backing as required."

We think that the Tax Court was amply warranted in finding that there was no evidence in this record, other than the simple fact that taxpayer had used his talents as a

building contractor to organize a large number of companies to conduct such building operations, that he was interested in any way in doing any more than enabling these separate corporations to achieve a successful and lucrative operation as corporations. Taxpayer's claim, it seems clear to us, falls within the class of those who fail to recognize the distinction between carrying on one's business through a corporate form, which of course, requires some organizing and financing, and the business of dealing in corporations, which may likewise require some financing arrangements. As stated by the Court of Appeals for the Ninth Circuit in *Holz* v. *Commissioner of Internal Revenue*, 256 F. 2d 865, at page 870:

> "Where the former is the situation, it is hornbook law, and not contested by petitioner, that the corporate entity is the primary debtor and stockholder loans to protect his investment or increase its value do not create a separate business for the stockholders. As the Fifth Circuit recently said in distinguishing the Giblin case, supra, 'Petitioner was not engaged in the [fol. 188] business of dealing in enterprises.' Pokress v. C.I.R., 1956, 234 F. 2d 146, 150 note 12. Nor did the Tax Court, nor do we, find him so engaged here. The finding of the Tax Court is binding upon us unless clearly erroneous. Here, it is not."

This opinion then cited the case of *Burnet* v. *Clark*, 287 U. S. 410, where at page 415 the Supreme Court said:

> "[The taxpayer] was not regularly engaged in indorsing notes, or buying and selling corporate securities. The unfortunate indorsements were not part of his ordinary business, but occasional transactions intended to preserve the value of his investment in capital shares."

The case of *Ferguson* v. *Commissioner*, 4 Cir. 253 F. 2d 403, is equally persuasive of the correctness of the Tax Court's decision here. In that case it was said, "It is now well settled that debts such as these are not deductible as business bad debts unless the taxpayer is so extensively

engaged in the business of promoting or financing business ventures as to elevate that activity to the status of a separate business." 253 F. 2d 403, 406.

So far as relates to the petitioner's contention that he was engaged in the separate business of lending money, we think that the Tax Court's finding that the relatively small number of interest bearing loans made by the taxpayer did not constitute a separate business engaged in by him. Furthermore, we think it was certainly within the ability of the Tax Court to find as a fact that the particular [fol. 189] advances made to the Mission Orange Company, especially the $48,000 advanced on the date on which it stripped itself of all of its physical assets, were not made in the course of a separate business conducted by the taxpayer. We certainly cannot find that this determination by the Tax Court was clearly erroneous.

The decision of the Tax Court is Affirmed.

HUTCHESON, Circuit Judge, Dissenting:

The sole question for decision in this case is whether the $56,975.10 debt of Mission Orange Bottling Company of Lubbock, Inc., to petitioner, A. J. Whipple, was a business bad debt or a non-business bad debt within the meaning of Sec. 23 (k) (1) or Section 23 (k) (4), respectively, Internal Revenue Code of 1939. I am unable to agree with the opinion of the majority, and, for the reasons hereinafter stated, I dissent.

It was stipulated: (1) that it was a debt; and (2) that it became worthless in 1953.

The answer to the question turns on whether or not the loss resulting from the debt's becoming worthless did or did not bear a proximate relationship to the conduct of a business in which petitioner Whipple was engaged at the time the debt became worthless.

The taxpayer is here insisting that the tax court below and the government in its brief and on oral argument have [fol. 190] failed to recognize and give effect to the fact that, though taxpayer's activities which gave the debt rise might not lend themselves to a specific name or label, they were certainly of a business nature within the meaning and

intent of the act, in that the petitioner engaged in them for the purpose of deriving income therefrom, and the bad debt loss suffered had a direct relationship to the conduct of these business activities.

I agree with these views. While the act is loosely drawn and has the fault of a negative approach to definition, that is, seems to be more concerned with stating what is not, than with what is, a business debt, we think that the language of the statute and regulation involved[1] and its legislative

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[1] *Internal Revenue Code of 1939:*

"Sec. 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

* * * *

[As amended by Sec. 1346 (a) Rev. Act. of 1942 c. 619 56 Stat. 798] (k) Bad Debts. —

"(1) General rule. — Debts which become worthless within the taxable year; * * *. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection. * * *"

* * * *

"(4) Non-business debts. — In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt, the worthlessness of which is incurred in the taxpayer's trade or business."

* * * *

(26 U. S. C. 1952 ed. Sec. 23)

"Treasury Regulations 118 (1939 Code):

"Sec. 39.23 (k) — 6. Non-business bad debts. (a) * * *

"(b) The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a nonbusiness debt for the purposes of this section."

[fol. 191] history[2] shows that the intent was not to deny a business bad debt deduction under the facts presented in this case.

I think, too, that the tax court, the Commissioner, and the majority opinion of this court have erred when, instead of relying on the language and legislative history of the act, they have placed their reliance on the gloss which has been put on the statute by various and sundry decisions cited by them which have construed this remedial statute so narrowly as practically to defeat its remedial purpose.

The language of the act and its legislative history both show that congress, desiring to encourage risk taking with [fol. 192] respect to loans incurred in connection with business and to discourage the making of loans for use taxwise to kinsmen or friends, gave favorable tax treatment to bad debts arising out of, or in connection with business ventures, while denying such treatment to purely personal bad debts or those where other than business considerations motivated the lending. I think that the purpose of the statute was, and

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[2] As the House of Representatives Report No. 2333, 77th Congress, First Session, states in regard to the Revenue Act of 1942, at page 409 of Cumulative Bulletin 1942-2:

> "The present law gives the same tax treatment to bad debts incurred in non-business transactions as it allows to business bad debts. An example *of a non-business bad debt would be an unrepaid loan to a friend or relative, while business bad debts arise in the course of the taxpayer's trade or business.* This liberal allowance for non-business bad debts has suffered considerable abuse through taxpayers making loans which they do not expect to be repaid. This practice is particularly prevalent in the case of loans to persons with respect to whom the taxpayer is not entitled to a credit for dependents. The situation has presented serious administrative difficulties because of the requirement of proof." (emphasis added)

The Senate Committee Reports contain no further explanation of the purpose for the insertion of the subsection which became 23 (k) (4).

The relationship which the loan must have to a taxpayer's business was explained in the House Committee Report on page 431 of C.B. 1942-2 where it quoted from Treasury Regulation 118, as shown in note 1, above, and then went on to give illustrations of debts which were incurred in what was obviously a business transaction to show how the time of the debt's becoming worthless would control in determining its proximate relationship to the taxpayer's business.

is, not advanced and the remedy is completely defeated when the mischief the statute was designated to meet is dropped entirely out of consideration, as in the board's decision here, in some of the decisions the board relies on, and in the majority opinion.

In the beginning of the interpretation of the statute and its application, the decisions were not so at fault. In the very first year of the applicability of Sec. 23 (k) (4), 1943, the question of how proximate the relationship of the debt to a business of the taxpayer must be was raised and decided in the case of Robert Cluett, 3rd, et ux v. Commissioner, 8 T. C. 1178 (1947). In that case the taxpayer sold a one-fourth ownership in a stock exchange seat for $125,000 and took a note from the purchaser for $65,000. The purchaser subsequently went bankrupt, leaving $28,985.97 owing on the note. The taxpayer deducted this sum as a business bad debt and the court allowed it as such.[3]

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[3] In allowing this as a business bad debt, the court said:

"The principal contention of the respondent seems to be that the loss from the bad debt in question did not arise in the ordinary course of the operation of a business involving the buying and selling of stock exchange seats. The petitioner does not contend that he was regularly engaged in any such business. Neither does he contend that the loss in question was one sustained in a usual transaction of any partnership of which he was a member. He contends, however, that the loss resulted directly from the operation of the business in which he was regularly engaged, both at the time the sale was made and at the time the debt became worthless, and, in the alternative, that the loss was at least proximately related to or connected with the business. * * *"

"*The legislative history of Sec. 23 (k) (4) indicated that its principal purpose was to place a limitation upon losses from bad debts, such as loans to relatives or friends which had no connection with the business* of the lender. * * * (Emphasis supplied)

"The debt here in question was not the result of a loan by the petitioner to a friend or relative or an isolated transaction which bore no relation whatsoever to the business in which he was engaged, but, on the contrary, was closely related to the business of owning and using a stock exchange membership for the production of income, in which business the petitioner was engaged not only in 1929, when the debt was created, but also in 1943, when it became worthless. * * *"

[fol. 193] It is significant to note, that the Treasury Department acquiesced in this interpretation of the statute, 1942-2 CB (2).

The next case to pass on the meaning of Sec. 23 (k) (4), was that of *Campbell* v. *Commissioner*, 11 T. C. 510 (1948), involving the taxable year 1944. The three petitioners in the Campbell case had been engaged since 1929 in organizing, owning and operating corporations (in total 12) engaged in the retail coal business. It was their practice as a part of their business to advance to (or leave with) those corporations on open account money belonging to them in many different instances. One of those corporations was the Campbell Bros. Coal Co. of Akron. The loans to that company which were in question were similar to loans made to others of their companies. The court, in determining that the loss resulting from such worthlessness was a business bad debt, denied the government's claim that taxpayer's loss fell under Section 23 (k) (4).[4]

[fol. 194] The commissioner also acquiesced in this case, decided in 1948, 1949-1 CB (1).

The Treasury's acquiescence in the Cluett and Campbell cases has never been withdrawn, and they still stand as the basic interpretative decisions on the statute.

The taxpayer in the Cluett case was certainly not in the business of selling stock exchange seats, and Mr. Campbell was not in the business of selling coal companies. Yet the government contends, and the tax court and the majority

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[4] The court said: "* * * They were debts, the loss from the worthlessness of which was incurred in the taxpayer's business. A finding has been made that they were business rather than non-business bad debts, because the evidence shows that they had a direct connection with the business carried on by these petitioners, and the losses were directly the result of, and incurred in, the business of *organizing and operating corporations engaged in the retail coal business, which business of organizing and operating such corporations was carried on by the petitioners during the taxable year. These are not cases in which losses of corporations are being confused with losses of individuals or in which the business of a corporation is being confused with the business of individuals.* Nor are they like net loss carry-over cases in which the loss occurred in isolated transactions rather than in the operation of a business. * * *" (Emphasis added)

have erroneously held, that in order for the loss to be deductible, taxpayer Whipple must show that the numerous corporate enterprises which he promoted, financed, and managed were formed by him for sale. This extension of the restriction on the qualification of business bad debts contended for by commissioner and tax court considerably restricts the remedy which congress provided for curing the mischief it had in mind. I think it clear that such restriction was never contemplated by Congress. Indeed the contention pressed here emasculates a clearly intended remedial law.

Looking at the question in the light of the language of the act and its legislative history, I am in no doubt that the [fol. 195] tax court was wrong in citing and relying on cases to the contrary of these views for such a restrictive and defeating construction.

I am also of the opinion that the great weight and number of the decided cases[5] and the strength of their reasoning support petitioner's view. The case of *Giblin* v. *Commissioner*, note 5, supra, decided by this court, carefully and correctly construed and applied the statute and gave it a construction and application which the petitioner contends for and is entitled to here.

It seems to me that the basic fault of the majority opinion is in holding, as it in effect does, that business bad debt treatment must be denied the taxpayer here because the loan was to a corporation in which he was interested. This holding is, in my opinion, a clear addition to the taxing statute. If congress had so intended, it could and would have so provided. Not having done so, neither the tax court nor this court can construe the statute as though it contained such provision.

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[5] Giblin v. Commissioner, 227 F (2) 692; Maytag v. U. S., 289 F (2) 647; Trent v. Commissioner, 291 F (2) 669; Maloney v. Spencer, 172 F (2) 638; Sage v. Commissioner, 15 T. C. 299; Foss v. Commissioner, 75 F (2) 326; Commissioner v. Stokes Estate, 200 F (2) 637; Scott v. Commissioner, 14 TCM 1029.

[fol. 196]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 18963

A. J. WHIPPLE and MILDRED WHIPPLE

versus

COMMISSIONER OF INTERNAL REVENUE.

JUDGMENT—April 4, 1962

This cause came on to be heard on the petition of A. J. Whipple and Mildred Whipple for review of a decision of the Tax Courts of the United States, and was argued by counsel;

On Consideration Whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the Tax Court in this cause be, and the same is hereby, affirmed.

"Hutcheson, Circuit Judge, Dissenting."

[fol. 197]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 18,963

[Title omitted]

PETITION FOR REHEARING—Filed April 24, 1962

The Petitioners, A. J. Whipple and Mildred Whipple, respectfully petition this Honorable Court for a rehearing of the appeal in the above entitled cause, and in support of this petition represent to the Court as follows:

1. The majority of the Court in the Court of Appeals for the Fifth Circuit, erred as did the Tax Court when it

failed to make any finding as to Petitioner's contention, on which ample evidence was introduced, that he was in the business of acquiring, owning, expanding, equipping and leasing bottling plants, a proximate result of the conduct of which business the $56,975.00 bad debt loss resulted in 1953, within the rule of *Maloney* v. *Spencer* (9th Cir.) 172 Fed. 2d 638.

[fol. 198] 2. The majority of the Court in the Court of Appeals for the Fifth Circuit perpetuated the error of the Tax Court by failing to make any finding as to whether a combination of Petitioner's activities, which resulted in the generation of $95,950.14 of ordinary income in the years 1951-53, constituted a business in which the Petitioner sustained the $56,975.10 bad debt loss in 1953. The Court segregated Petitioner's activities into specific lines of endeavor, considered them separately, and concluded that Petitioner was not in that particular business, thereby overlooking his contention that his operations as a proprietor, as a stockholder, as a partner or as a lender *or in a combination of these capacities*, contributing to each enterprise his own initiative and energy, and such financial backing as it required, constituted a business distinct in itself.

3. The majority of the Court in the Court of Appeals for the Fifth Circuit erred as a matter of law in holding, in effect, that in order for a taxpayer to receive the benefits of business bad debt relief he must show that he was in the business of dealing in enterprises and forming corporations for sale. The majority of the Court erroneously placed this interpretation on the case of *Giblin* v. *Commissioner* (5th Cir.) 227 Fed. 2d 692, because the record in that case shows that Giblin did not meet such a requirement.

4. The majority of the Court in the Court of Appeals for the Fifth Circuit erred in failing to consider the criteria established by the legislative history of Sections 23(k)(1) and 23(k)(4) of the *Internal Revenue Act* of 1939 in that such history indicates that the statute was intended to have a strict remedial application and not to disallow

the full deduction to individuals engaged in activities such as Petitioner.

[fol. 199] 5. The majority of the Court in the Court of Appeals for the Fifth Circuit erred as a matter of law in holding, in effect, that business bad debt treatment should be denied Petitioner, A. J. Whipple, because the loans in question were made to a corporation in which he was interested.

6. The majority of the Court in the Court of Appeals for the Fifth Circuit erred in failing to recognize that the activities of Petitioner, A. J. Whipple, were more extensive than were those of the taxpayer in *Giblin* v. *Commissioner* (5th Cir.) 227 Fed. 2d 692, in the creation of ordinary income, as a proximate result of which activities he suffered a bad debt loss.

7. That part of the holding of the majority of the Court in the Court of Appeals for the Fifth Circuit in which reference is made to the Tax Court's comments on the date of the debt becoming worthless and the finding "thus it appears that at the time the sum of $48,000.00 of the indebtedness in issue was advanced to Mission Orange petitioner had no hope of its being recovered" was clearly erroneous because it goes behind the stipulations made by the parties in the Tax Court. It was stipulated before the Tax Court: "8. That as of December 31, 1953, Mission Orange Bottling Co. of Lubbock, Inc., was indebted to petitioner, A. J. Whipple, in the amount of $56,975.10, and that such debt had become worthless in 1953, and the sole issue remaining as to said sum of $56,975.10 is whether said sum is a business bad debt or a non-business bad debt within the meaning of Section 23(k)(1) or Section 23(k)(4), respectively, *Internal Revenue Code* of 1939." Petitioner, therefore, introduced no evidence, nor was it necessary to determine the exact date of the debt's becoming worthless.

[fol. 200] For the foregoing reasons this Petition should be granted.

Charles Dillingham, Ben H. Schleider, Jr., Attorneys for Petitioners.

Charles Dillingham, Ben H. Schleider, Jr., 802 Texas National Bank Building, Houston 2, Texas.

THE STATE OF TEXAS)
COUNTY OF HARRIS)

CHARLES DILLINGHAM, being duly sworn, on oath certifies and says:

That he is one of the attorneys for Petitioners in this cause; that he makes this certificate in compliance with Rule 29 of the Rules of this Court; that in his judgment the within and foregoing Petition for Rehearing is well founded and is presented in good faith and not for delay.

Charles Dillingham.

Sworn to and Subscribed before me this the 23 day of April, 1962.

Ida R. Horn, Notary Public in and for Harris County, Texas.

Certificate of service (omitted in printing).

[fol. 201] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 18,963

[Title omitted]

Petition for Review of Decision of the Tax Court of the United States

ORDER DENYING PETITION FOR REHEARING—May 11, 1962

Before Tuttle, Chief Judge, Hutcheson and Rives, Circuit Judges.

Per Curiam:

It is Ordered that the petition for rehearing filed in the above styled and numbered cause be, and the same is, hereby Denied.

Hutcheson, Circuit Judge: "I Dissent."

[fol. 202] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 18,963

[Title omitted]

MOTION FOR STAY OF MANDATE—Filed May 18, 1962

A. J. Whipple and Mildred Whipple, Petitioners, move the Court to enter an Order staying the issuance of the mandate in the above-entitled case because it is the bona fide intention of the Petitioners to make proper application to the Supreme Court of the United States for a Writ of Certiorari in this case, within the next ninety days, and in support hereof Petitioners incorporate the certificate

[fol. 203] of their counsel, Charles Dillingham of Houston, Texas.

I hereby certify that it is the bona fide intention of the Petitioners to make application to the Supreme Court of the United States for a Writ of Certiorari within the next ninety days, and that I believe there is merit in Petitioners' case and that the decision of the United States Court of Appeals for the Fifth Circuit ought to be reversed by the Supreme Court of the United States.

Petitioners would further show that there is presently on file in the Tax Court of the United States where this case originated under Docket No. 65603 in that Court, a bond in the amount of $28,000 signed by Petitioners, as principals, and St. Paul Fire and Marine Insurance Company, St. Paul, Minnesota, as surety, conditioned on the prosecution of the petition for review of Petitioners and payment of the deficiency as finally determined together with any interest, additional amounts or additions to the tax provided for law, the amount of said bond having been fixed by the Judge who heard the case in the Court below, and Petitioners would move that such security be approved by this Court as sufficient for the stay.

Wherefore, Petitioners pray that the Court Order that [fol. 204] the issuance of mandate in the above-entitled case be stayed for a reasonable time to enable the Petitioners to obtain a Writ of Certiorari from the Supreme Court of the United States, and Petitioners further pray that the Court approve the bond now on file in the Tax Court for this stay.

Respectfully submitted,

Charles Dillingham, Counsel for Petitioners, 802 Texas National Bank Building, Houston 2, Texas.

Certificate of service (omitted in printing).

[fol. 205] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 18963

[Title omitted]

ORDER STAYING MANDATE—May 28, 1962

On Consideration of the Application of the petitioners in the above numbered and entitled cause for a stay of the mandate of this Court therein, to enable petitioners to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, It Is Ordered that the issue of the mandate of this Court in said cause be and the same is stayed for a period of 90 days from May 11, 1962; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within 90 days from May 11, 1962 there shall be filed with the Clerk of this Court the certificate of the Clerk of the Supreme Court that certiorari petition and record have been filed. It is further ordered that the Clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of 90 days from May 11, 1962, unless the above-mentioned certificate shall be filed with the Clerk of this Court within that time.

Elbert P. Tuttle, Chief Judge.

[fol. 206] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 207]

SUPREME COURT OF THE UNITED STATES

No. 305—October Term, 1962

A. J. WHIPPLE, et al., Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER ALLOWING CERTIORARI—October 22, 1962

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 208]

BEFORE THE
TAX COURT OF THE UNITED STATES

PETITIONERS' EXHIBIT NO. 13-M

FORM 1040 U. S. Treasury Department Internal Revenue Service

U. S. INDIVIDUAL INCOME TAX RETURN

FOR CALENDAR YEAR 1952

1952

For the year beginning ..., 1952, and ending ..., 19...

Name A. J. Whipple and wife, Willie Mae Whipple
(PLEASE PRINT)

HOME ADDRESS 4[illegible] Fernwood
(PLEASE PRINT)

Houston Texas

Social Security No. 464-24-[illegible] Occupation

Do not write in these spaces

Your exemptions

1 (a) Last name. If your wife or husband had no income, or if this is a joint return, list also her or his name

A A. J. Whipple
B Willie Mae Whipple

Check below if 65 or over ... Blind

Check below if 65 or over ... Blind

Do not write in these spaces
If box 1A is blank, write the figure 1
If box 1B is blank, write the figure 1
If both 1A and 1B are blank, write the figure 2

Number of exemptions claimed ... 1
Number of persons in the family ... 2

(b) Name and address of first employer

(c) Last names of your children (including step-children and legally adopted children) who received more than one-half of their support from you in 1952. See Instructions

A. J. Whipple, Jr.
Billie Jo Whipple

Enter number of children listed ... 2

D Enter number claimed for other relatives listed on Schedule I on page 2

E Enter total number of exemptions claimed in A to D above ... 4

Your income

2 Enter your total wages, salaries, bonuses, commissions, and other compensation received in 1952 before payroll deductions. Persons earning over $4,200 a year see Instructions

(Name of employer) (When employed) (Gross amount) $

(Name of employer) (When employed) (Gross amount) $

Scrubble

3 If you received dividends, interest, rents, royalties, or other income, give details on page 2 and enter the total here ... $ 32,250.00 $ 3,142.46

4 Add income shown in items 2 and 3, and enter the total here ... $ 32,250.00

How to figure the tax

Before beginning your tax, see Schedule I for Heads of Households. If you claim such status, check here ...

IF YOUR INCOME WAS LESS THAN $5,000 Use the tax table on page 4 unless you itemize deductions. The table allows about 10 per cent of average itemized deductions. If you itemize deductions, figure your tax on page 3 unless you elect to take 10 per cent of your wages (but not more than $1,000) as your deductions, and enter your tax on page 3.

IF YOUR INCOME WAS $5,000 OR MORE Complete the appropriate Tax Computation Schedule on page 3 and enter your tax on page 3, whether you itemize deductions or not, unless you elect to take 10 per cent of your wages (but not more than $1,000) as your deductions, which may be to your advantage.

Tax due or refund

5 (a) Enter your tax from table on page 4 or Tax Computation Schedule on page 3 ... $ 33,392.12

(b) Enter your exemptions (not less than $600) ... $ 3,000

6 How much have you paid on your 1952 income tax?

A By tax withheld (item 2, above) ... $ 3,142.46

B By payments on 1952 Declaration of Estimated Tax ...

C Any overpayment on your 1951 return claimed as credit ...

Enter total here ... $ 3,142.46

7 If your tax (item 5) is larger than payments (item 6), enter balance of tax due here. This balance must be paid with this return ... $ 30,249.66

8 If your payments (item 6) are more than your tax (item 5), enter amount of overpayment here ... $

Enter amount of item 8 you want: Refunded to you $ ... Credited on your 1953 estimated tax $ ...

Did you file any prior year Federal tax for which you have been billed? Year or Years ... If husband and wife, making a separate return for 1952? (Yes or No) ... If "Yes," write her or his name ...

If you have applied a return for a prior year, state latest year ... Where filed ... Amount, if known ...

To which internal revenue collector's office did you pay amounts claimed in item 6, B, above ...

I declare under the penalties of perjury that this return (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is a true, correct, and complete return.

Wm. B. Ellzey CPA 3/24/53 A. J. Whipple

(Name of person other than taxpayer who prepared return) (Date) (Signature of taxpayer)

(Address of person other than taxpayer who prepared return)

To secure joint refund, husband and wife must each sign. If all taxable income and gross income through community property must be reported by husband

154
[fol. 209]

1 o 96 3

Schedule A.—INCOME FROM DIVIDENDS

Name of payer	Amount	Name of payer	Amount	
Whipple Lumber Co., Inc.	$ 3,220 00		$	
			Enter total here →	$ 3,220 00

Schedule B.—INCOME FROM INTEREST

Name of payer	Amount	Name of payer	Amount	
	$ Schedule		$	
			Enter total here →	2,285 35

Schedule C Summary.—PROFIT (OR LOSS) FROM BUSINESS OR PROFESSION, FARMING, AND PARTNERSHIPS

1. Business profit (or loss) from separate Schedule C, line 23	Loss	$ 11,259 71)
2. Farm profit (or loss) from separate schedule, Form 1040F		
3. Partnership, etc., profit (or loss) from Form 1065, Schedule K, Column 3		29,198 37
4. Total of lines 1, 2, 3	Schedule (Partnership name) (Address)	$ 18,138 66
5. Less: Net operating loss deduction (attach statement)		
6. Net profit (or loss) (line 4 less line 5)		18,138 66

Schedule D.—NET GAIN OR LOSS FROM SALES OR EXCHANGES OF CAPITAL ASSETS, ETC.

1. From sale or exchange of capital assets (from separate Schedule D)	(1,000 00)
2. From sale or exchange of property other than capital assets (from separate Schedule D)	

Schedule E.—INCOME FROM ANNUITIES OR PENSIONS

1. Cost of annuity (amount you paid)	$	4. Amount received this year	$
2. Cost received tax-free in past years		5. Excess of line 4 over line 3	
3. Remainder of cost (line 1 less line 2)	$	6. Enter line 5, or 3 percent of line 1, whichever is greater (but not more than line 4)	

Schedule F.—INCOME FROM RENTS AND ROYALTIES

1. Kind and location of property	2. Amount of rent or royalty (names in Schedule H)	3. Expenses of operation	4. Depreciation allowed	5. Other expenses (attach schedule)	
House-Houston, Texas	$ 1,008 08	522 08	$	$ 498 07	
Building & warehouses Houston	17,661 42	1,452 90			
Conc'l bldg. Inkbook	- 0 -	216 73		399 08	
1. Totals	$ 18,669 50	2,201 69		$ 897 15	
2. Net profit (or loss) (column 2 less sum of columns 3, 4, and 5)					15,570 58

Schedule G.—INCOME FROM ESTATES AND TRUSTS AND OTHER SOURCES

1. Estate or trust (Name) (Address)		
2. Other sources (state nature)		
Total income (or loss) from above sources (Enter here and as item 3, page 1)		$ 38,214 59

Schedule H.—EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULE F

1. Kind of property (if building, state material of which constructed. Include land and other nondepreciable property)	2. Date acquired	3. Cost or other basis	4. Depreciation allowed in prior years	5. Depreciation allowable in current year	6. Life used for computing depreciation	7. Method used (Straight line, declining balance, etc.)	8. Depreciation allowable this year
Frame rent house	4-51	$10,621 25	$ 354 72	$ 10,286 53	20		$ 532 06
Frame building and warehouses	2-51	29,058 08	1,271 28	27,786 80	20		1,452 90
Conc'l. concrete block	10-1-52	39,990 11	- 0 -	39,011 95	30		1 216 73

Schedule I.—EXEMPTIONS FOR CLOSE RELATIVES—(See Instructions)

Name of person entitled to exemption and relationship to you	Age	(a) Number of months lived in your home	(b) Number of months supported by you	(c) Number of months support furnished by you	If (a) is either 12 or 0 is the entire amount spent by you included in (c)?	If (b) is 12 is the entire amount spent by you included in (c)?
					$	$

Enter here and as item 1D, page 1, the number of close relatives claimed above

Schedule J.—HEAD OF HOUSEHOLD (See Instructions)
(Not applicable where wife or husband died during taxable year)

1. Were you unmarried (or legally separated) at the close of your taxable year? (Yes or No)
2. Did any person for whom you are entitled to an exemption, as your unmarried child, grandchild, or stepchild, even though not a dependent, share during your entire taxable year your home which was your principal residence? (Yes or No)
   Last name(s) and relationship to you
3. Did you furnish more than one half of the cost of maintaining the household during the taxable year? (Yes or No)
   If you did not furnish the entire cost, state total amount furnished by you $; by all others (including those sharing your home) $
4. If all of the above questions are answered "Yes," you may determine your tax as Head of a Household.

[fol: 210]

Albert J. and wife, Mildred Whipple

Year 1952

Page 1 Line 2

Employer's Name	Where Employed	Total Wages	Income Tax Withheld
Whipple Lumber Co., Inc.	Houston, Texas	$ 12,000.00	$ 1,867.20
Dozier-Whipple Const. Corp.	" "	4,800.00	446.80
Angleton Homes Corp.	" "	5,400.00	547.20
Whipple Construction Co., Inc.	" "	5,400.00	547.20
Whipple Equipment Co., Inc.	" "	1,800.00	- 0 -
F.I.C.A. employee tax withheld:			
Dozier-Whipple Const. Corp.			54.00
Angleton Homes Corp.			54.00
Whipple Const. Co., Inc.			54.00
Whipple Equipment Co., Inc.			27.00
		$ 29,400.00	$ 3,797.40
Commissions: Federated Department Stores, Inc.		1,260.00	
		$ 30,660.00	

156
[fol. 211]

Albert J. and wife, Mildred Whipple

Year 1952

Schedule B Income from Interest

Name of payer	Amount	
A. J. Whipple Construction Co.	$ 44.28	
G. A. Durham	74.33	
L. B. Olive	4.76	
Whipple Lumber Co., Inc.	868.51	
Dora Kilsey	45.61	
Cecil Clark	45.61	
D. M. Dosier	45.61	
Willard Evans	45.61	
Durham-Clark Building Supply Co.	57.95	
Whipple Equipment Co., Inc.	575.51	
Whipple Construction Co., Inc.	5.61	
Dosier-Whipple Const. Corp.	393.89	
Harland Miller	47.60	
The Brag Club, Inc.	53.97	$ 2,307.35
Less accrued and unpaid in 1951:		
W. T. Atkins	$ 20.81	
Roy J. Pate	1.19	22.00
Total income from interest		$ 2,285.35

[fol. 212]

PROFIT (OR LOSS) FROM BUSINESS OR PROFESSION 1952

(For Computation of Self-Employment Tax, see Page 3)

For Calendar Year 1952 or taxable year beginning _____, 1952, and ending _____, 19__

Name and Address (from Form 1040) Albert J. Whipple and wife, Mildred Whipple, Houston, Texas

(Partnerships and joint ventures should file on Form 1065)

(I) Principal business activity (see instructions) Restaurant (Retail trade, wholesale trade, lawyer, etc.) Food (Principal product or service)

(II) Business name Cousin's (III) FICA employer identification number, if any (see instructions) 476 11234(M)

(IV) Business address (see instructions) 4401 Fannin St. (Street and number or rural route) Houston (City, town, post office) Harris (County) Texas (State)

(V) Were you the sole proprietor of this business in 1951? Yes ☒ No ☐ If "No," check whether this business in 1952 became a successor to a corporation ☐, a partnership ☐, another sole proprietorship ☐, or started as an entirely new business ☐. Where applicable, give name of such predecessor _____

Do NOT include cost of goods withdrawn for personal use or deductions not connected with your business or profession

1	Total receipts from business or profession			$ 212,226 79
	COST OF GOODS SOLD			
2	Inventory at beginning of year	$ 63,949	13	
3	Merchandise bought for manufacture or sale	74,757	54	
4	Cost of labor	28,790	12	
5	Material and supplies	3,386	00	
6	Other costs (explain in Schedule C-2)			
7	Total of lines 2 to 6	$170,882	79	
8	Less inventory at end of year	4,293	43	
9	Net cost of goods sold (line 7 less line 8)			166,589 36
10	Gross profit (line 1 less line 9)			$ 45,637 43
	OTHER BUSINESS DEDUCTIONS			
11	Salaries and wages not included in line 4	$ 10,367	80	
12	Rent on business property	4,750	00	
13	Interest on business indebtedness	621	94	
14	Taxes on business and business property	2,190	24	
15	Losses of business property (attach statement)			
16	Bad debts arising from sales or services	722	26	
17	Depreciation and obsolescence (explain in Schedule C-1)	4,932	23	
18	Repairs (explain in Schedule C-2)	3,717	17	
19	Depletion of mines, oil and gas wells, timber, etc. (submit schedule)			
20	Amortization of emergency facilities (attach statement)			
21	Other business expenses (explain in Schedule C-2)	29,395	50	
22	Total of lines 11 to 21			56,697 14
23	Enter net profit or loss (line 10 less line 22). Also enter on line 24, page 3, and on line 1, Schedule C, Summary, Form 1040	Loss		$ 11,059 71

Schedule C-1. EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED ON LINE 17

1 Kind of property (if real estate, give location and other identifying information)	2 Date acquired	3 Cost or other basis	4 Depreciation allowed or allowable in prior years	5 Method used for computing depreciation	6 Life used for computing depreciation	7 Depreciation allowed this year	8 Depreciation allowable this year
		$	$				$

Schedule attached

Schedule C-2. EXPLANATION OF LINES 6, 18, AND 21

Line no.	Explanation	Amount	Line no.	Explanation	Amount
		$			$

Schedule attached

Albert J. and Mildred Whipple

Year 1952

Schedule C-2 Line 22

Advertising	$ 11,838.68
Auto and truck expense	1,389.82
Bank service charges	36.16
Commission	2,200.00
Dues and subscriptions	441.40
Dishes, silverware, etc.	902.40
Electricity	1,897.71
Entertainment and travel	1,590.58
Freight	145.49
Gas	581.62
Insurance	1,749.02
Legal and professional	584.50
Licenses and permits	165.85
Linen service	3,466.33
Miscellaneous	876.43
Office supplies	993.34
Telephone and telegraph	704.77
Water	[illegible]
	$ 29,3[illegible]

Albert J. and wife, Mildred Whirrle

Year 1952

Schedule C-1 Depreciation

[fol. 214]

Kind of Property	Date Acquired	Cost	Depreciation Allowed in Prior Years	Remaining Cost	Life Used Years	Depreciation Allowable This Year
Dining room furniture:						
34 sq. yds carpeting	12/1/51	$ 103.53	$ 4.63	$ 98.90	1	$ 98.90
9 plastic covered booths	12/1/51	1,287.34	35.76	1,251.58	3	[illegible]
59' wall bench plastic	12/1/51	1,267.59	35.21	[illegible]	3	[illegible]
28' plastic wall panel	12/1/51	207.68	5.77	[illegible]	3	69.22
46 plywood table tops	12/1/51	262.16	21.85	240.31	1	240.31
183 plastic covered chairs	12/1/51	1,603.69	44.55	1,559.14	3	534.56
46 table bases	12/1/51	424.24	7.07	417.17	3	139.05
6 table tops	12/1/51	113.92	2.07	121.85	3	[illegible]
2 wood floor lamps	12/1/51	36.56	1.02	35.54	3	[illegible]
plastic covered sectional	12/1/51	220.00	6.11	213.89	3	71.29
6 tables	12/1/51	141.44	3.93	137.51	3	45.83
Air conditioning unit	12/1/51	3,800.00	63.33	3,736.67	5	760.00
2 wood chairs	12/1/51	25.58	.43	25.15	5	5.11
Fire extinguisher	12/1/51	97.49	1.63	95.86	5	19.00
Burnishing machine	2/1/52	175.00		175.00	10	16.06
51½ yds. carpet	2/9/52	711.00		711.00	8	124.43
Air conditioning unit	6/30/52	932.06		932.06	8	58.25
		$ 11,419.26	$ 237.36	$ 11,181.90		$ 3,316.26
Office furniture and equipment:						
Desk and typewriter	12/1/51	$ 45.84	$ 1.47	$ 44.37	3	$ 14.78
Chair	12/1/51	4.58	.13	[illegible]	[illegible]	[illegible]
Wood file cabinet	12/1/51	7.50	.63	6.87	1	[illegible]
Table and mimeograph machine	12/1/51	57.00	.95	[illegible]	[illegible]	[illegible]
Floor safe	12/1/51	[illegible]	.21	[illegible]	[illegible]	[illegible]
Electric adding machine	12/1/51	260.30	2.17	[illegible]	[illegible]	[illegible]
Metal file cabinet	12/1/51	336.73	.76	[illegible]	[illegible]	[illegible]
Cash register	12/1/51	[illegible]	6.48	[illegible]	[illegible]	[illegible]
Printing machine	3/27/52	[illegible]		[illegible]	[illegible]	[illegible]
		$ 1,5[illegible]	$ 12.98	$ 1,499.[illegible]		$ [illegible]

159

Schedule C-1 Depreciation

Kind of Property	Date Acquired	Cost	Depreciation Allowed in Prior Years	Remaining Cost	Life Used	Depreciation Allowable This Year
Kitchen equipment:						
Various (used)	12/1/51	$ 4,370.70	$ 72.88	$ 4,297.82	5	$ 874.14
7-cu refrigerator	12/1/51	106.75	.89	105.86	10	10.67
Slicing machine	12/24/51	75.00		75.00	5	15.00
Various	3/52	68.45		68.45	3	17.10
Sunbeam mixmaster	5/19/52	34.95		34.95	5	4.06
Various	7/52	90.50		90.50	3	14.55
"	8/52	43.51		43.51	3	4.80
Galvanized drain	8/15/52	63.75		63.75	10	2.00
Charcoal broiler	9/3/52	135.00		135.00	10	4.52
Clear air unit	9/3/52	295.00		295.00	5	19.68
Fume fan	9/3/52	168.44		168.44	5	11.24
Hotpoint fry kettle	9/22/52	68.66		68.66	5	3.27
" dutch oven	9/22/52	90.26		90.26	5	4.50
Everhot roaster	9/22/52	30.57		30.57	5	1.53
		$ 5,638.54	$ 73.77	$ 5,564.77		$ 985.06
Leasehold improvements:						
	12/31	$ 930.00	$ 8.16	$ 921.84	9½	$ 97.94
	1st six mos. 52	4,323.88		4,323.88	9	480.43
	2nd six mos. 52	1,607.84		1,607.84	8½	189.16
		$ 6,861.72	$ 8.16	$ 6,853.56		$ 767.53
Total year 1952		$ 25,431.14	$ 331.87	$ 25,099.27		$ 4,932.23

160 [fol. 235]

[fol. 216]

COMPUTATION OF SELF-EMPLOYMENT TAX

(For old-age and survivors insurance)

Name of self-employed person

State nature of business, if any, subject to self-employment tax

24. Net profit (or loss) shown on line 23, page 1	(11053 21)	
25. Loss of husband or wife shown on line 15, page 1		
26. Total (Line 24 plus 25)		$
27. Less Net [illegible] (If not applicable, enter 0)		
28. Net earnings from self-employment (line 26 less line 27)		$
29. Net earnings (or loss) from self-employment from partnerships, joint ventures, etc. (from column 10, Schedule K, Form 1065)		
30. Total net earnings (or loss) from self-employment (line 28 plus line 29). If total net earnings is under $400, do not make any entries below		$
31. Maximum amount subject to self-employment tax	$ 3,600 00	
32. Less: Wages paid to you during the taxable year which were subject to withholding for old-age and survivors insurance. If such wages exceed $3,600, enter $3,600		
33. Maximum amount subject to self-employment tax after adjustment for wages	$	
34. Self-employment income subject to tax. Line 30 or 33, whichever is smaller		$
35. Self-employment tax. 2½ percent of amount on line 34. Enter here and as item 5 (B), page 1, Form 1040		$

FILL IN ITEMS BELOW BUT DO NOT DETACH

Date stamp (for returns made to T.I.S. OFFICE) — U.S. TREASURY DEPARTMENT (Internal Revenue Service)

U. S. REPORT OF SELF-EMPLOYMENT INCOME

(For Federal Old-Age and Survivors Insurance)

1952

For calendar year 1952 or fiscal year beginning , 1952, and ending , 19

State nature of business subject to self-employment tax

ENTER HERE THE SOCIAL SECURITY ACCOUNT NUMBER OF THE PERSON NAMED BELOW

ENTER BELOW NAME OF SELF-EMPLOYED PERSON AND BUSINESS ADDRESS

(Name)

(Number and street or rural route)

(City, town, or post office, and State)

Enter total net earnings from self-employment shown on line 30 above $

Enter wages shown on line 32 above $

Enter self-employment income shown on line 34 above $

Albert J. and wife, Mildred Whipple

Year 1952

Schedule C Partnership Income

A. J. Whipple Construction Co.

First fiscal year ended 1/31/52	$ 21,367.09
Final return 8/31/52	7,753.92
Refund received after final return and dissolution	525.00
	$ 29,646.01

Less:

Lee County Leases	Loss	447.64
		$ 29,198.37

[fol. 218]

Department of the Treasury
Internal Revenue Service

SCHEDULE D (Form 1040) — GAINS AND LOSSES FROM SALES OR EXCHANGES OF PROPERTY — 1962

For Calendar Year 1962 or taxable year beginning ____, 1962, and ending ____, 19__

Name and address: A. J. Thipple and wife, Mildred Thipple

(1) CAPITAL ASSETS

1 Kind of property (Example—100 shares of "X" Co.)	2 Date acquired (Mo., day, yr.)	3 Date sold (Mo., day, yr.)	4 Gross sales price	5 Cost or other basis (see instructions)	6 Expense of sale	7 LOSS (If column 5 exceeds column 4)	8 GAIN (If column 4 exceeds column 5)
SHORT-TERM CAPITAL GAINS AND LOSSES—ASSETS HELD NOT MORE THAN 6 MONTHS							
1. Balance on conversion option on Zeni			$	$	$		
2. Enter your share of net short-term gain or loss from partnerships and common trust funds							
3. Enter unused capital loss carryover from 5 preceding taxable years (attach statement)							
4. Enter sum of short-term gain or losses or difference between short-term gain and losses shown above							
LONG-TERM CAPITAL GAINS AND LOSSES—ASSETS HELD FOR MORE THAN 6 MONTHS							
5			$	$	$		
6. Enter the full amount of your share of net long-term gain or loss from partnerships and common trust funds							
7. Enter sum of long-term gains or losses or difference between long-term gains and losses shown above							

8. Enter net short-term gain or loss from line 4	$	
9. Enter net long-term gain or loss from line 7	$ None	$

Use lines 10 through 13 only if gains exceed losses on lines 8 and 9.

10. Enter short-term gain (line 8, col. a) reduced by any short-term loss (line 9, col. b)	$	
11. Enter long-term gain (line 9, col. a) reduced by any short-term loss (line 8, col. b)	$	
12. Enter 50 percent of line 11	$	
13. Enter here and on line 1, Schedule D, page 2, Form 1040, the smaller of line 10 or 12	$	

Use lines 14 and 15 only if losses exceed gains on lines 8 and 9.

14. Enter the excess of losses over gains on lines 8 and 9		
15. Enter here and on line 1, Schedule D, page 2, Form 1040, the smaller of line 14 or $1,000 ($500 if married and not separate return), reduced by the amount on line 14 (if married filing separate return, enter one-half of amount on line 14 and one-half of capital gain net income (if $1,000))		

COMPUTATION OF ALTERNATIVE TAX

(For use only if net long-term capital gain exceeds net short-term capital gain and net long-term capital gain exceeds taxable income on line 28, page 1, Form 1040, minus net long-term capital gain)

16. Enter taxable income from line 28, page 1, Form 1040, the income from line 5, Schedule D, page 2, Form 1040, or joint return		
17. Enter amount from line 12, col. a, if separate return, the amount from line 12, col. a, if joint return		
18. Subtract line 17 from line 16		
19. Enter amount from line 18 (use Tax Rate Schedule)		
20. Enter amount from line 17		
21. Enter amount from line 12, col. b		
22. Add lines 20 and 21		
23. Enter amount from line 18		
24. Enter amount from line 23 (use Tax Rate Schedule)		
25. Enter amount from line 22		
26. Subtract line 25 from line 24		
27. Enter 25 percent of line 12, col. b		
28. Add lines 19 and 27		
29. Enter amount from line 16 (use Tax Rate Schedule)		
30. Enter amount from line 28		
31. Subtract line 30 from line 29		
32. Enter 50 percent of line 11		
33. Add lines 30 and 32		
34. Enter amount from line 16 (use Tax Rate Schedule)		
35. Enter amount from line 33		
36. Subtract line 35 from line 34		
37. Enter 25 percent of line 12, col. b		
38. Add lines 31 and 37		
39. Enter amount from line 38		
40. Enter amount from line 28		
41. Subtract line 40 from line 39		
42. Enter 50 percent of line 11		
43. Add lines 40 and 42		
44. Enter amount from line 16 (use Tax Rate Schedule)		
45. Enter amount from line 43		
46. Subtract line 45 from line 44		
47. Enter 25 percent of line 12, col. b		
48. Add lines 41 and 47		
49. Enter amount from line 48		
50. Enter amount from line 28		
51. Subtract line 50 from line 49		
52. Enter 50 percent of line 11		
53. Add lines 50 and 52		
54. Enter amount from line 16 (use Tax Rate Schedule)		
55. Enter amount from line 53		
56. Subtract line 55 from line 54		
57. Enter 25 percent of line 12, col. b		
58. Add lines 51 and 57		
59. Enter amount from line 58		
60. Enter amount from line 28		
61. Subtract line 60 from line 59		
62. Enter 50 percent of line 11		
63. Add lines 60 and 62		
64. Enter amount from line 16 (use Tax Rate Schedule)		
65. Enter amount from line 63		
66. Subtract line 65 from line 64		
67. Enter 25 percent of line 12, col. b		
68. Add lines 61 and 67		
69. Enter amount from line 68		
70. Enter amount from line 28		
71. Subtract line 70 from line 69		
72. Enter 50 percent of line 11		
73. Add lines 70 and 72		
74. Enter amount from line 16 (use Tax Rate Schedule)		
75. Enter amount from line 73		
76. Subtract line 75 from line 74		
77. Enter 25 percent of line 12, col. b		
78. Add lines 71 and 77		
79. Enter amount from line 78		
80. Enter amount from line 28		
81. Subtract line 80 from line 79		
82. Enter 50 percent of line 11		
83. Add lines 80 and 82		
84. Enter amount from line 16 (use Tax Rate Schedule)		
85. Enter amount from line 83		
86. Subtract line 85 from line 84		
87. Enter 25 percent of line 12, col. b		
88. Add lines 81 and 87		
89. Enter amount from line 88		
90. Enter amount from line 28		
91. Subtract line 90 from line 89		
92. Enter 50 percent of line 11		
93. Add lines 90 and 92		
94. Enter amount from line 16 (use Tax Rate Schedule)		
95. Enter amount from line 93		
96. Subtract line 95 from line 94		
97. Enter 25 percent of line 12, col. b		
98. Add lines 91 and 97		
99. Enter amount from line 98		
100. Enter amount from line 28		
101. Subtract line 100 from line 99		
102. Enter 50 percent of line 11		
103. Add lines 100 and 102		
104. Enter amount from line 16 (use Tax Rate Schedule)		
105. Enter amount from line 103		
106. Subtract line 105 from line 104		
107. Enter 25 percent of line 12, col. b		
108. Add lines 101 and 107		
109. Enter amount from line 108		
110. Enter amount from line 28		
111. Subtract line 110 from line 109		
112. Enter 50 percent of line 11		
113. Add lines 110 and 112		
114. Enter amount from line 16 (use Tax Rate Schedule)		
115. Enter amount from line 113		
116. Subtract line 115 from line 114		
117. Enter 25 percent of line 12, col. b		
118. Add lines 111 and 117		
119. Enter amount from line 118		
120. Enter amount from line 28		
121. Subtract line 120 from line 119		
122. Enter 50 percent of line 11		
123. Add lines 120 and 122		
124. Enter amount from line 16 (use Tax Rate Schedule)		
125. Enter amount from line 123		
126. Subtract line 125 from line 124		
127. Enter 25 percent of line 12, col. b		
128. Add lines 121 and 127		
129. Enter amount from line 128		
130. Enter amount from line 28		
131. Subtract line 130 from line 129		
132. Enter 50 percent of line 11		
133. Add lines 130 and 132		
134. Enter amount from line 16 (use Tax Rate Schedule)		
135. Enter amount from line 133		
136. Subtract line 135 from line 134		
137. Enter 25 percent of line 12, col. b		
138. Add lines 131 and 137		
139. Enter amount from line 138		
140. Enter amount from line 28		
141. Subtract line 140 from line 139		
142. Enter 50 percent of line 11		
143. Add lines 140 and 142		
144. Enter amount from line 16 (use Tax Rate Schedule)		
145. Enter amount from line 143		
146. Subtract line 145 from line 144		
147. Enter 25 percent of line 12, col. b		
148. Add lines 141 and 147		
149. Enter amount from line 148		
150. Enter amount from line 28		
151. Subtract line 150 from line 149		
152. Enter 50 percent of line 11		
153. Add lines 150 and 152		
154. Enter amount from line 16 (use Tax Rate Schedule)		
155. Enter amount from line 153		
156. Subtract line 155 from line 154		
157. Enter 25 percent of line 12, col. b		
158. Add lines 151 and 157		
159. Enter amount from line 158		
160. Enter amount from line 28		
161. Subtract line 160 from line 159		
162. Enter 50 percent of line 11		
163. Add lines 160 and 162		
164. Enter amount from line 16 (use Tax Rate Schedule)		
165. Enter amount from line 163		
166. Subtract line 165 from line 164		
167. Enter 25 percent of line 12, col. b		
168. Add lines 161 and 167		
169. Enter amount from line 168		
170. Enter amount from line 28		
171. Subtract line 170 from line 169		
172. Enter 50 percent of line 11		
173. Add lines 170 and 172		
174. Enter amount from line 16 (use Tax Rate Schedule)		
175. Enter amount from line 173		
176. Subtract line 175 from line 174		
177. Enter 25 percent of line 12, col. b		
178. Add lines 171 and 177		
179. Enter amount from line 178		
180. Enter amount from line 28		
181. Subtract line 180 from line 179		
182. Enter 50 percent of line 11		
183. Add lines 180 and 182		
184. Enter amount from line 16 (use Tax Rate Schedule)		
185. Enter amount from line 183		
186. Subtract line 185 from line 184		
187. Enter 25 percent of line 12, col. b		
188. Add lines 181 and 187		
189. Enter amount from line 188		
190. Enter amount from line 28		
191. Subtract line 190 from line 189		
192. Enter 50 percent of line 11		
193. Add lines 190 and 192		
194. Enter amount from line 16 (use Tax Rate Schedule)		
195. Enter amount from line 193		
196. Subtract line 195 from line 194		
197. Enter 25 percent of line 12, col. b		
198. Add lines 191 and 197		
199. Enter amount from line 198		
200. Enter amount from line 28		
201. Subtract line 200 from line 199		
202. Enter 50 percent of line 11		
203. Add lines 200 and 202		
204. Enter amount from line 16 (use Tax Rate Schedule)		
205. Enter amount from line 203		
206. Subtract line 205 from line 204		
207. Enter 25 percent of line 12, col. b		
208. Add lines 201 and 207		
209. Enter amount from line 208		
210. Enter amount from line 28		
211. Subtract line 210 from line 209		
212. Enter 50 percent of line 11		
213. Add lines 210 and 212		
214. Enter amount from line 16 (use Tax Rate Schedule)		
215. Enter amount from line 213		
216. Subtract line 215 from line 214		
217. Enter 25 percent of line 12, col. b		
218. Add lines 211 and 217		
219. Enter amount from line 218		
220. Enter amount from line 28		
221. Subtract line 220 from line 219		
222. Enter 50 percent of line 11		
223. Add lines 220 and 222		
224. Enter amount from line 16 (use Tax Rate Schedule)		
225. Enter amount from line 223		
226. Subtract line 225 from line 224		
227. Enter 25 percent of line 12, col. b		
228. Add lines 221 and 227		
229. Enter amount from line 228		
230. Enter amount from line 28		
231. Subtract line 230 from line 229		
232. Enter 50 percent of line 11		
233. Add lines 230 and 232		
234. Enter amount from line 16 (use Tax Rate Schedule)		
235. Enter amount from line 233		
236. Subtract line 235 from line 234		
237. Enter 25 percent of line 12, col. b		
238. Add lines 231 and 237		
239. Enter amount from line 238		
240. Enter amount from line 28		
241. Subtract line 240 from line 239		
242. Enter 50 percent of line 11		
243. Add lines 240 and 242		
244. Enter amount from line 16 (use Tax Rate Schedule)		
245. Enter amount from line 243		
246. Subtract line 245 from line 244		
247. Enter 25 percent of line 12, col. b		
248. Add lines 241 and 247		
249. Enter amount from line 248		
250. Enter amount from line 28		
251. Subtract line 250 from line 249		
252. Enter 50 percent of line 11		
253. Add lines 250 and 252		
254. Enter amount from line 16 (use Tax Rate Schedule)		
255. Enter amount from line 253		
256. Subtract line 255 from line 254		
257. Enter 25 percent of line 12, col. b		
258. Add lines 251 and 257		
259. Enter amount from line 258		
260. Enter amount from line 28		
261. Subtract line 260 from line 259		
262. Enter 50 percent of line 11		
263. Add lines 260 and 262		
264. Enter amount from line 16 (use Tax Rate Schedule)		
265. Enter amount from line 263		
266. Subtract line 265 from line 264		
267. Enter 25 percent of line 12, col. b		
268. Add lines 261 and 267		
269. Enter amount from line 268		
270. Enter amount from line 28		
271. Subtract line 270 from line 269		
272. Enter 50 percent of line 11		
273. Add lines 270 and 272		
274. Enter amount from line 16 (use Tax Rate Schedule)		
275. Enter amount from line 273		
276. Subtract line 275 from line 274		
277. Enter 25 percent of line 12, col. b		
278. Add lines 271 and 277		
279. Enter amount from line 278		
280. Enter amount from line 28		
281. Subtract line 280 from line 279		
282. Enter 50 percent of line 11		
283. Add lines 280 and 282		
284. Enter amount from line 16 (use Tax Rate Schedule)		
285. Enter amount from line 283		
286. Subtract line 285 from line 284		
287. Enter 25 percent of line 12, col. b		
288. Add lines 281 and 287		
289. Enter amount from line 288		
290. Enter amount from line 28		
291. Subtract line 290 from line 289		
292. Enter 50 percent of line 11		
293. Add lines 290 and 292		
294. Enter amount from line 16 (use Tax Rate Schedule)		
295. Enter amount from line 293		
296. Subtract line 295 from line 294		
297. Enter 25 percent of line 12, col. b		
298. Add lines 291 and 297		
299. Enter amount from line 298		
300. Enter amount from line 28		
301. Subtract line 300 from line 299		
302. Enter 50 percent of line 11		
303. Add lines 300 and 302		
304. Enter amount from line 16 (use Tax Rate Schedule)		
305. Enter amount from line 303		
306. Subtract line 305 from line 304		
307. Enter 25 percent of line 12, col. b		
308. Add lines 301 and 307		
309. Enter amount from line 308		
310. Enter amount from line 28		
311. Subtract line 310 from line 309		
312. Enter 50 percent of line 11		
313. Add lines 310 and 312		
314. Enter amount from line 16 (use Tax Rate Schedule)		
315. Enter amount from line 313		
316. Subtract line 315 from line 314		
317. Enter 25 percent of line 12, col. b		
318. Add lines 311 and 317		
319. Enter amount from line 318		
320. Enter amount from line 28		
321. Subtract line 320 from line 319		
322. Enter 50 percent of line 11		
323. Add lines 320 and 322		
324. Enter amount from line 16 (use Tax Rate Schedule)		
325. Enter amount from line 323		
326. Subtract line 325 from line 324		
327. Enter 25 percent of line 12, col. b		
328. Add lines 321 and 327		
329. Enter amount from line 328		
330. Enter amount from line 28		
331. Subtract line 330 from line 329		
332. Enter 50 percent of line 11		
333. Add lines 330 and 332		
334. Enter amount from line 16 (use Tax Rate Schedule)		
335. Enter amount from line 333		
336. Subtract line 335 from line 334		
337. Enter 25 percent of line 12, col. b		
338. Add lines 331 and 337		
339. Enter amount from line 338		
340. Enter amount from line 28		
341. Subtract line 340 from line 339		
342. Enter 50 percent of line 11		
343. Add lines 340 and 342		
344. Enter amount from line 16 (use Tax Rate Schedule)		
345. Enter amount from line 343		
346. Subtract line 345 from line 344		
347. Enter 25 percent of line 12, col. b		
348. Add lines 341 and 347		
349. Enter amount from line 348		
350. Enter amount from line 28		
351. Subtract line 350 from line 349		
352. Enter 50 percent of line 11		
353. Add lines 350 and 352		
354. Enter amount from line 16 (use Tax Rate Schedule)		
355. Enter amount from line 353		
356. Subtract line 355 from line 354		
357. Enter 25 percent of line 12, col. b		
358. Add lines 351 and 357		
359. Enter amount from line 358		
360. Enter amount from line 28		
361. Subtract line 360 from line 359		
362. Enter 50 percent of line 11		
363. Add lines 360 and 362		
364. Enter amount from line 16 (use Tax Rate Schedule)		
365. Enter amount from line 363		
366. Subtract line 365 from line 364		
367. Enter 25 percent of line 12, col. b		
368. Add lines 361 and 367		
369. Enter amount from line 368		
370. Enter amount from line 28		
371. Subtract line 370 from line 369		
372. Enter 50 percent of line 11		
373. Add lines 370 and 372		
374. Enter amount from line 16 (use Tax Rate Schedule)		
375. Enter amount from line 373		
376. Subtract line 375 from line 374		
377. Enter 25 percent of line 12, col. b		
378. Add lines 371 and 377		
379. Enter amount from line 378		
380. Enter amount from line 28		
381. Subtract line 380 from line 379		
382. Enter 50 percent of line 11		
383. Add lines 380 and 382		
384. Enter amount from line 16 (use Tax Rate Schedule)		
385. Enter amount from line 383		
386. Subtract line 385 from line 384		
387. Enter 25 percent of line 12, col. b		
388. Add lines 381 and 387		
389. Enter amount from line 388		
390. Enter amount from line 28		
391. Subtract line 390 from line 389		
392. Enter 50 percent of line 11		
393. Add lines 390 and 392		
394. Enter amount from line 16 (use Tax Rate Schedule)		
395. Enter amount from line 393		
396. Subtract line 395 from line 394		
397. Enter 25 percent of line 12, col. b		
398. Add lines 391 and 397		
399. Enter amount from line 398		
400. Enter amount from line 28		
401. Subtract line 400 from line 399		
402. Enter 50 percent of line 11		
403. Add lines 400 and 402		
404. Enter amount from line 16 (use Tax Rate Schedule)		
405. Enter amount from line 403		
406. Subtract line 405 from line 404		
407. Enter 25 percent of line 12, col. b		
408. Add lines 401 and 407		
409. Enter amount from line 408		
410. Enter amount from line 28		
411. Subtract line 410 from line 409		
412. Enter 50 percent of line 11		
413. Add lines 410 and 412		
414. Enter amount from line 16 (use Tax Rate Schedule)		
415. Enter amount from line 413		
416. Subtract line 415 from line 414		
417. Enter 25 percent of line 12, col. b		
418. Add lines 411 and 417		
419. Enter amount from line 418		
420. Enter amount from line 28		
421. Subtract line 420 from line 419		
422. Enter 50 percent of line 11		
423. Add lines 420 and 422		
424. Enter amount from line 16 (use Tax Rate Schedule)		
425. Enter amount from line 423		
426. Subtract line 425 from line 424		
427. Enter 25 percent of line 12, col. b		
428. Add lines 421 and 427		
429. Enter amount from line 428		
430. Enter amount from line 28		
431. Subtract line 430 from line 429		
432. Enter 50 percent of line 11		
433. Add lines 430 and 432		
434. Enter amount from line 16 (use Tax Rate Schedule)		
435. Enter amount from line 433		
436. Subtract line 435 from line 434		
437. Enter 25 percent of line 12, col. b		
438. Add lines 431 and 437		
439. Enter amount from line 438		
440. Enter amount from line 28		
441. Subtract line 440 from line 439		
442. Enter 50 percent of line 11		
443. Add lines 440 and 442		
444. Enter amount from line 16 (use Tax Rate Schedule)		
445. Enter amount from line 443		
446. Subtract line 445 from line 444		
447. Enter 25 percent of line 12, col. b		
448. Add lines 441 and 447		
449. Enter amount from line 448		
450. Enter amount from line 28		
451. Subtract line 450 from line 449		
452. Enter 50 percent of line 11		
453. Add lines 450 and 452		
454. Enter amount from line 16 (use Tax Rate Schedule)		
455. Enter amount from line 453		
456. Subtract line 455 from line 454		
457. Enter 25 percent of line 12, col. b		
458. Add lines 451 and 457		
459. Enter amount from line 458		
460. Enter amount from line 28		
461. Subtract line 460 from line 459		
462. Enter 50 percent of line 11		
463. Add lines 460 and 462		
464. Enter amount from line 16 (use Tax Rate Schedule)		
465. Enter amount from line 463		
466. Subtract line 465 from line 464		
467. Enter 25 percent of line 12, col. b		
468. Add lines 461 and 467		
469. Enter amount from line 468		
470. Enter amount from line 28		
471. Subtract line 470 from line 469		
472. Enter 50 percent of line 11		
473. Add lines 470 and 472		
474. Enter amount from line 16 (use Tax Rate Schedule)		
475. Enter amount from line 473		
476. Subtract line 475 from line 474		
477. Enter 25 percent of line 12, col. b		
478. Add lines 471 and 477		
479. Enter amount from line 478		
480. Enter amount from line 28		
481. Subtract line 480 from line 479		
482. Enter 50 percent of line 11		
483. Add lines 480 and 482		
484. Enter amount from line 16 (use Tax Rate Schedule)		
485. Enter amount from line 483		
486. Subtract line 485 from line 484		
487. Enter 25 percent of line 12, col. b		
488. Add lines 481 and 487		
489. Enter amount from line 488		
490. Enter amount from line 28		
491. Subtract line 490 from line 489		
492. Enter 50 percent of line 11		
493. Add lines 490 and 492		
494. Enter amount from line 16 (use Tax Rate Schedule)		
495. Enter amount from line 493		
496. Subtract line 495 from line 494		
497. Enter 25 percent of line 12, col. b		
498. Add lines 491 and 497		
499. Enter amount from line 498		
500. Enter amount from line 28		
501. Subtract line 500 from line 499		
502. Enter 50 percent of line 11		
503. Add lines 500 and 502		
504. Enter amount from line 16 (use Tax Rate Schedule)		
505. Enter amount from line 503		
506. Subtract line 505 from line 504		
507. Enter 25 percent of line 12, col. b		
508. Add lines 501 and 507		
509. Enter amount from line 508		
510. Enter amount from line 28		
511. Subtract line 510 from line 509		
512. Enter 50 percent of line 11		
513. Add lines 510 and 512		
514. Enter amount from line 16 (use Tax Rate Schedule)		
515. Enter amount from line 513		
516. Subtract line 515 from line 514		
517. Enter 25 percent of line 12, col. b		
518. Add lines 511 and 517		
519. Enter amount from line 518		
520. Enter amount from line 28		
521. Subtract line 520 from line 519		
522. Enter 50 percent of line 11		
523. Add lines 520 and 522		
524. Enter amount from line 16 (use Tax Rate Schedule)		
525. Enter amount from line 523		
526. Subtract line 525 from line 524		
527. Enter 25 percent of line 12, col. b		
528. Add lines 521 and 527		
529. Enter amount from line 528		
530. Enter amount from line 28		
531. Subtract line 530 from line 529		
532. Enter 50 percent of line 11		
533. Add lines 530 and 532		
534. Enter amount from line 16 (use Tax Rate Schedule)		
535. Enter amount from line 533		
536. Subtract line 535 from line 534		
537. Enter 25 percent of line 12, col. b		
538. Add lines 531 and 537		
539. Enter amount from line 538		
540. Enter amount from line 28		
541. Subtract line 540 from line 539		
542. Enter 50 percent of line 11		
543. Add lines 540 and 542		
544. Enter amount from line 16 (use Tax Rate Schedule)		
545. Enter amount from line 543		
546. Subtract line 545 from line 544		
547. Enter 25 percent of line 12, col. b		
548. Add lines 541 and 547		
549. Enter amount from line 548		
550. Enter amount from line 28		
551. Subtract line 550 from line 549		
552. Enter 50 percent of line 11		
553. Add lines 550 and 552		
554. Enter amount from line 16 (use Tax Rate Schedule)		
555. Enter amount from line 553		
556. Subtract line 555 from line 554		
557. Enter 25 percent of line 12, col. b		
558. Add lines 551 and 557		
559. Enter amount from line 558		
560. Enter amount from line 28		
561. Subtract line 560 from line 559		
562. Enter 50 percent of line 11		
563. Add lines 560 and 562		
564. Enter amount from line 16 (use Tax Rate Schedule)		
565. Enter amount from line 563		
566. Subtract line 565 from line 564		
567. Enter 25 percent of line 12, col. b		
568. Add lines 561 and 567		
569. Enter amount from line 568		
570. Enter amount from line 28		
571. Subtract line 570 from line 569		
572. Enter 50 percent of line 11		
573. Add lines 570 and 572		
574. Enter amount from line 16 (use Tax Rate Schedule)		
575. Enter amount from line 573		
576. Subtract line 575 from line 574		
577. Enter 25 percent of line 12, col. b		
578. Add lines 571 and 577		
579. Enter amount from line 578		
580. Enter amount from line 28		
581. Subtract line 580 from line 579		
582. Enter 50 percent of line 11		
583. Add lines 580 and 582		
584. Enter amount from line 16 (use Tax Rate Schedule)		
585. Enter amount from line 583		
586. Subtract line 585 from line 584		
587. Enter 25 percent of line 12, col. b		
588. Add lines 581 and 587		
589. Enter amount from line 588		
590. Enter amount from line 28		
591. Subtract line 590 from line 589		
592. Enter 50 percent of line 11		
593. Add lines 590 and 592		
594. Enter amount from line 16 (use Tax Rate Schedule)		
595. Enter amount from line 593		
596. Subtract line 595 from line 594		
597. Enter 25 percent of line 12, col. b		
598. Add lines 591 and 597		
599. Enter amount from line 598		
600. Enter amount from line 28		
601. Subtract line 600 from line 599		
602. Enter 50 percent of line 11		
603. Add lines 600 and 602		
604. Enter amount from line 16 (use Tax Rate Schedule)		
605. Enter amount from line 603		
606. Subtract line 605 from line 604		
607. Enter 25 percent of line 12, col. b		
608. Add lines 601 and 607		
609. Enter amount from line 608		
610. Enter amount from line 28		
611. Subtract line 610 from line 609		
612. Enter 50 percent of line 11		
613. Add lines 610 and 612		
614. Enter amount from line 16 (use Tax Rate Schedule)		
615. Enter amount from line 613		
616. Subtract line 615 from line 614		
617. Enter 25 percent of line 12, col. b		
618. Add lines 611 and 617		
619. Enter amount from line 618		
620. Enter amount from line 28		
621. Subtract line 620 from line 619		
622. Enter 50 percent of line 11		
623. Add lines 620 and 622		
624. Enter amount from line 16 (use Tax Rate Schedule)		
625. Enter amount from line 623		
626. Subtract line 625 from line 624		
627. Enter 25 percent of line 12, col. b		
628. Add lines 621 and 627		
629. Enter amount from line 628		
630. Enter amount from line 28		
631. Subtract line 630 from line 629		
632. Enter 50 percent of line 11		
633. Add lines 630 and 632		
634. Enter amount from line 16 (use Tax Rate Schedule)		
635. Enter amount from line 633		
636. Subtract line 635 from line 634		
637. Enter 25 percent of line 12, col. b		
638. Add lines 631 and 637		
639. Enter amount from line 638		
640. Enter amount from line 28		
641. Subtract line 640 from line 639		
642. Enter 50 percent of line 11		
643. Add lines 640 and 642		
644. Enter amount from line 16 (use Tax Rate Schedule)		
645. Enter amount from line 643		
646. Subtract line 645 from line 644		
647. Enter 25 percent of line 12, col. b		
648. Add lines 641 and 647		
649. Enter amount from line 648		
650. Enter amount from line 28		
651. Subtract line 650 from line 649		
652. Enter 50 percent of line 11		
653. Add lines 650 and 652		
654. Enter amount from line 16 (use Tax Rate Schedule)		
655. Enter amount from line 653		
656. Subtract line 655 from line 654		
657. Enter 25 percent of line 12, col. b		
658. Add lines 651 and 657		
659. Enter amount from line 658		
660. Enter amount from line 28		
661. Subtract line 660 from line 659		
662. Enter 50 percent of line 11		
663. Add lines 660 and 662		
664. Enter amount from line 16 (use Tax Rate Schedule)		
665. Enter amount from line 663		
666. Subtract line 665 from line 664		
667. Enter 25 percent of line 12, col. b		
668. Add lines 661 and 667		
669. Enter amount from line 668		
670. Enter amount from line 28		
671. Subtract line 670 from line 669		
672. Enter 50 percent of line 11		
673. Add lines 670 and 672		
674. Enter amount from line 16 (use Tax Rate Schedule)		
675. Enter amount from line 673		
676. Subtract line 675 from line 674		
677. Enter 25 percent of line 12, col. b		
678. Add lines 671 and 677		
679. Enter amount from line 678		
680. Enter amount from line 28		
681. Subtract line 680 from line 679		
682. Enter 50 percent of line 11		
683. Add lines 680 and 682		
684. Enter amount from line 16 (use Tax Rate Schedule)		
685. Enter amount from line 683		
686. Subtract line 685 from line 684		
687. Enter 25 percent of line 12, col. b		
688. Add lines 681 and 687		
689. Enter amount from line 688		
690. Enter amount from line 28		
691. Subtract line 690 from line 689		
692. Enter 50 percent of line 11		
693. Add lines 690 and 692		
694. Enter amount from line 16 (use Tax Rate Schedule)		
695. Enter amount from line 693		
696. Subtract line 695 from line 694		
697. Enter 25 percent of line 12, col. b		
698. Add lines 691 and 697		
699. Enter amount from line 698		
700. Enter amount from line 28		
701. Subtract line 700 from line 699		
702. Enter 50 percent of line 11		
703. Add lines 700 and 702		
704. Enter amount from line 16 (use Tax Rate Schedule)		
705. Enter amount from line 703		
706. Subtract line 705 from line 704		
707. Enter 25 percent of line 12, col. b		
708. Add lines 701 and 707		
709. Enter amount from line 708		
710. Enter amount from line 28		
711. Subt

Albert J. and wife, Mildred Whipple

Year 1952

Schedule F Income from Rents

Other Expenses

Rent House:		
Advalorem taxes	$ 160.35	
Interest on loan	337.72	
		$ 498.07
Commercial Building in Lubbock:		
Interest on loan		179.08
Total Other Expenses		$ 677.15

[fol. 220]

Contributions	Rockley School		
	Veterans Memorial Fund		
	Harris County T. B. Fund		
	United Fund		
	Allowable Contributions (not in excess of 20 percent of item 4, page 1)		
Interest	J. E. Perley and Sons		
	Total Interest		
Taxes	State, county and city on homestead		
	Total Taxes		
Losses from fire, storm, or other casualty, or theft	Total Allowable Losses (not compensated by insurance or otherwise)		
Medical and dental expenses (of self, wife or husband)	Net Expenses (not compensated by insurance or otherwise)		
	Enter 5 percent of item 4, page 2, and subtract from Net Expenses		
	Allowable Medical and Dental Expenses. See Instructions for limitation		
Miscellaneous deductions (see instructions)	Total Miscellaneous Deductions		
	Total Deductions		1,170 [illegible]

TAX COMPUTATION—FOR PERSONS NOT USING TAX TABLES ON PAGE 4

1	Enter amount shown on item 4, page 1. This is your Adjusted Gross Income	[illegible]
2	If deductions are itemized above, enter total of such deductions. If deductions are not itemized and line 1, above, is $5,000 or more, (a) married persons filing separately enter $500, (b) all others enter 10 percent of line 1, but not more than $1,000	1,170 [illegible]
3	Subtract line 2 from line 1. Enter the difference here. This is your Net Income	[illegible]
4	Multiply $600 by total number of exemptions claimed in item 1b, page 1. Enter total here	2,400 00
5	Subtract line 4 from line 3. Enter difference here. (If line 1 includes partially tax-exempt interest, see Instructions)	[illegible]
	If line 5 is less than $2,000	
6	Enter 2 percent of amount shown on line 5 and disregard lines 7, 8, and 9	
	If line 5 is over $2,000	
7	Are you (or is a single person, a married person filing separately, or a head of household	
	Single persons and married persons filing separately use Tax Rate Schedule I on page 12 of Instructions to figure tax on amount on line 5; heads of household use Tax Rate Schedule II	
8	Are you (or is [illegible] filing a joint return	
	a Enter amount shown on line 5	32,647 14
	b Use Tax Rate Schedule I on page 12 of Instructions to figure tax on amount on line 8	16,456 05
	c Multiply amount on line 8(b) by 2	32,912 10
9	If alternative tax computation is made, enter here tax from separate Schedule D	
	Disregard lines 10, 11, and 12, and enter on line 13 the same figure you entered on line 8, 9, 10(A), or 11, unless you used limited deductions	
10	Enter here any tax withheld on payments to a foreign country or U. S. possession which you elect to	
11	Enter here any tax withheld at source on tax-free covenant bond interest	
12	Add the items on lines 10 and 11 and enter the total here	
13	Subtract line 12 from line 7, 8 (c), or 9. Enter difference here and as item 5 (A), page 1	

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NO. 305

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

A. J. WHIPPLE & MILDRED WHIPPLE, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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INDEX

OPINIONS BELOW

JURISDICTION

QUESTION PRESENTED

STATUTES INVOLVED

STATEMENT

REASONS FOR GRANTING THE WRIT

A. Conflict of Decisions
B. Importance
C. Error of the Court Below

CONCLUSION

APPENDIX A—Statutes and Regulations

APPENDIX B—Opinions and judgment below

CITATIONS

CASES — PAGE

Campbell v. Commissioner, 11 TC 510 (1948) Acq. 1949-1 CB — 8, 16, 18

Cluett v. Commissioner, 8 TC 1178 (1947) Acq. 1947-2 CB — 8

Commissioner v. Stokes' Estate (3rd Cir.) 200 F.2d 637, 53-1 USTC 9164 — 7, 8, 16

Foss v. Commissioner (1st Cir.) 76 F.2d 326, 35-1 USTC 9091 — 7, 8, 16

Giblin v. Commissioner (5th Cir.) 227 F.2d 692, 56-1 USTC 9103 — 7, 8

Helvering v. Inter-Mountain Life Ins. Co., 294 U.S. 686, 79 L.Ed. 1229 — 9

Maloney v. Spencer (9th Cir.) 172 F.2d 638, 49-1 USTC 9176 — 6, 7, 11, 12, 13, 16, 17, 18

Mays v. Commissioner (6th Cir.) 272 F.2d 788, 60-1 USTC 9122 — 6, 8, 13, 14, 16, 19

Maytag v. United States, U.S. Court of Claims, 289 F.2d 647, 61-1 USTC 9424 — 6, 8, 9, 13, 16, 19

Rollins v. Commissioner (4th Cir.) 276 F.2d 368, 60-1 USTC 9357 — 13

Henry E. Sage v. Commissioner, 15 TC 299 — 16, 18

Charles H. Scott v. Commissioner, 14 TCM 1029 — 16, 18

Trent v. Commissioner (2nd Cir.) 291 F.2d 669, 61-2 USTC 9506 — 13, 14

STATUTES

Section 23 (k) (1) Internal Revenue Code, 1939, 26 USCA 23(k) (1) (IRC 1939) — 2, 14, 19, 23

Section 23 (k) (4) Internal Revenue Code, 1939, 26 USCA 23(k) (4) (IRC 1939) — 2, 13, 24

Section 1101, Internal Revenue Code, 1939, 26 USCA 1101 (IRC 1939) — 3

Section 7442, Internal Revenue Code, 1954, 26 USCA 7442 (IRC 1954) — 3

Section 166 (d), Internal Revenue Code, 1954, 26 USCA 116 (d) (IRC 1954) — 14

MISCELLANEOUS

Section 39.23 (k)-6, Income Tax Regulations, 26 CFR 39.23 (k)-6 — 2, 20, 24

Federal Income, Gift & Estate Taxation, Rabkin & Johnson, Sec. 35.01 (4) — 14

NO._____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

A. J. WHIPPLE & MILDRED WHIPPLE, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

A. J. Whipple and Mildred Whipple, Petitioners, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above entitled case on April 4, 1962.

CITATIONS TO OPINIONS BELOW

The opinion of the Tax Court is printed in Appendix B hereto, infra p. 26, and is reported as a memorandum decision in 19 TCM 187, TC Memo 1960-36.

The opinion of the Court of Appeals for the Fifth Circuit printed in Appendix B hereto, infra p. 41 is reported in 62-1 U.S.T.C. 9385, 301 F. 2d 108.

JURISDICTION

The judgment of the Court of Appeals was entered on April 4, 1962, R. 196, Appendix B, infra p. 55. Rehearing was denied on May 11, 1962. R. 201. Appendix B, infra p. 56. The jurisdiction of this Court is invoked under 28 *U.S.C.*, Sec. 1254(1).

QUESTION PRESENTED

The sole question for decision in this case is whether the $56,975.10 debt of Mission Orange Bottling Company of Lubbock Inc. to Petitioner, A. J. Whipple, was a business bad debt or a non-business bad debt within the meaning of Section 23 (k) (1) or Section 23 (k) (4) respectively *Internal Revenue Code of 1939*. It was stipulated that it was a debt and that it became worthless in 1953.

STATUTES INVOLVED

The statutory provisions involved are Section 23(k)(1) and Section 23(k)(4) of the *Internal Revenue Code of 1939*, 26 *U.S.C.A.*, p. 46 (I.R.C. 1939). They are printed in Appendix A, infra p. 23 and 24. Section 39.23(k)-6 of the *Income Tax Regulations*, 26 C.F.R. 39.23(k)-6 is printed in Appendix A, infra p. 24.

STATEMENT

This case originated in the Tax Court on a petition by A. J. Whipple and Mildred Whipple for redetermination of a deficiency claimed by the Commissioner of Internal

Revenue pursuant to Section 1101 of the Internal Revenue Act of 1939 and Section 7442 of the *Internal Revenue Code of 1954*. (R. 6-13). The Tax Court held that petitioner was not entitled to deduct a $56,975.10 loss as a business bad debt. (R. 31-45). The Court of Appeals for the Fifth Circuit, by a divided court, affirmed the decision of the Tax Court. (R. 196). Appendix B, infra p. 41.

The debt in dispute arose by reason of loans made by petitioner to Mission Orange Bottling Co. of Lubbock, Inc. It was stipulated that it was a debt and that such debt became worthless in 1953. (R. 56).

The petitioner, A. J. Whipple, entered business in 1941 when he and W. E. Brown were partners in the construction of houses. (R. 116). Beginning in about 1942 petitioner participated in the formation of seven partnerships with Miles Strickland and others. (R. 117-121). During 1949 and 1950, petitioner was an original incorporator of seven corporations. (R. 61).

During the four years from 1949 through 1953, Petitioner was instrumental in incorporating 15 corporations and acquiring an interest in 5 additional corporations. (R. 134) At one time or another during this period, he was also a member of 10 partnerships. (R. 134-136)

During this period of time the Petitioner spent a large part of his time and energy in the construction and real estate business and the related building supply business. (R. 162)

In addition to his activities connected with the construction business he bought and operated a restaurant (R. 128), promoted oil ventures in Western Texas and elsewhere (R. 88), promoted a tile distributorship (R. 119-21), and helped form a private club (R. 140).

He bought land for Foley's Warehouse when they only had five days in which to do it before construction was to be commenced, for which he was paid a fee reported as ordinary income. (R. 147) He was frequently brought other deals, such as a cinder-block business in 1953, to help promote and raise money. He went into a lumber yard promotion deal with Alex W. Head after that. (R. 89)

Petitioner, A. J. Whipple, made numerous loans to the various corporations and partnerships, in which he had an interest, throughout the years in issue. For instance, his 1951 income tax return shows loans to five of these corporations and three partnerships. (R. 134)

Petitioner continued in this business of financing corporations and lending money, as is shown by the schedule attached to his 1952 income tax return showing ordinary interest income received from 14 corporations, partnerships and individuals (Exhibit 13-M), and the advances in 1953 of $25,000 to $30,000 to Angleton Building and Holding Co. (R. 161), and $52,500.00 of advances to Mission Orange Bottling Co. of Lubbock, Inc. His income tax returns for the years 1951-53 reflect interest income of $1,680.85, $2,285.35 and $1,747.59 respectively. (R. 37-38)

In 1944, Petitioner, A. J. Whipple bought some land on Airline Road and formed a corporation to construct a lumber yard on it which was rented to Airline Lumber and Supply, Inc., and several partnerships. (R. 122-4) (R. 118-9)

Petitioner continued in the rental business, forming Whipple Equipment Corporation in 1951, to rent automobiles, trucks construction and other equipment. (R. 136) In addition he bought, personally, the property and buildings at 2436 Bissonnet, which he leased to Whipple Lumber Company Inc. (R. 137-9) He also built a rent house

in Houston. (Exhibit 13-M) (R. 60) Petitioner individually bought some land in Lubbock and built a plant on it, (R. 154) which he leased to Mission Orange Bottling Company of Lubbock, Inc. at a monthly rental of $500.00. (R. 36) For the taxable year ending December 31, 1952 Petitioners reported ordinary income of $15,570.58 (Exhibit 13-M) (R. 60-61) and in 1953 $12,225.19 as net rentals. (Exhibit 20-T) (R. 62).

On April 25, 1951, Petitioner obtained a franchise from Mission Dry Company entitling him personally to produce, bottle and supply Mission beverages in certain counties in Texas (R. 57). During the same month he purchased the bottling machinery and equipment then owned by one D. C. Casey, who was operating the Mission Orange Company in Lubbock, Texas. (R. 57) He conducted this business as a sole proprietorship until approximately July 1, 1951, at which time he organized the debtor corporation, Mission Orange Bottling Company of Lubbock, Inc., and transferred the bottling machinery and equipment to it. (R. 58) In 1952 petitioner erected a new bottling plant and leased it to Mission Orange. (R. 58) During the years 1951 through 1953, he made advances to the bottling corporation in the amount of $131,778.26. (R. 102) On December 15, 1953 Petitioner advanced Mission Orange $48,000 to pay trade creditors. (R. 113) He received a transfer from Mission Orange of bottling machinery, equipment and an automobile, which had the value of $70,414.66. (R. 112) This left a net amount due by Mission Orange to him of $56,975.10, which it was stipulated became worthless in 1953. (R. 56)

In addition to the bottling corporation in Lubbock, Petitioner organized a soft drinks distributorship corporation

in Amarillo (R. 150) and a separate soft drinks vending machine business. (R. 153)

Petitioner introduced evidence in the Tax Court on four different types of business activities carried on by taxpayer, A. J. Whipple, for the purpose of producing ordinary income. (R. 60-62) This evidence also showed that the $56,975.10 bad debt in question had resulted from loans having been made by Petitioners in the ordinary course of carrying on these business activities.

Petitioners urged before the Tax Court and the United States Court of Appeals for the Fifth Circuit that the bad debt loss had resulted from Petitioner, A. J. Whipple's business activities in

1. Organizing, financing and managing corporations, partnerships and joint-ventures; or
2. Financing corporations and lending money; or
3. Acquiring, owning, expanding, equipping and leasing bottling plants and other equipment; or
4. Conducting activities in connection with the bottling and sale of soft drinks; or
5. A combination of the above activities.

The majority of the Court of Appeals for the Fifth Circuit held that Petitioner, A. J. Whipple's activities in connection with points 1, 2 and 4 above did not qualify him for business bad debt treatment and the majority of the Court made no finding as to points 3 and 5.

The decision of the majority of the Court below in refusing to allow petitioner to treat his loss as a business bad debt is in conflict with the decisions of *Mays v. Commissioners* (6th Cir.), 272 F. 2d 788, 60-1 *U.S.T.C.* 9122, *Maytag v. United States*, U. S. Court of Claims, 289 F. 2d 647, 61-1 *U.S.T.C.* 9424 and *Maloney v. Spencer* (9th

Cir.), 172 F. 2d 638, 49-1 *U.S.T.C.* 9176, *Commissioner v. Stokes' Estate* (3rd Cir.), 200 F. 2d 637, 53-1 *U.S.T.C.* 9164, and *Foss v. Commissioner* (1st Cir.), 76 F. 2d 326, 35-1 *U.S.T.C.* 9091.

REASONS FOR GRANTING THE WRIT

A. CONFLICT OF DECISIONS

1. The majority of the Court of Appeals for the Fifth Circuit held that in order for a taxpayer to deduct as a business bad debt one of many loans made in the course of organizing, financing and operating numerous corporations, he must also prove that he formed the corporations for the purpose of selling them. This holding is in conflict with decisions in three circuits and the Court of Claims.

The court evidently based this holding on the earlier Fifth Circuit Court of Appeals decision of *Giblin v. Commissioner*, 227 F. 2d 692, 56-1 U.S.T.C. 9103 from which it quoted as follows:

> "Taxpayer did not seek to show that he was engaged in the business of making loans. Neither did he seek to have the Tax Court 'pierce the corporate veil' and find he was engaged in the restaurant business or in any of the other businesses which he had promoted and dealt with during the preceding twenty years. What he did seek to prove was that he was regularly engaged in the business of seeking out business opportunities, promoting, organizing and financing them, contributing to them substantially 50% of his time and energy *and then disposing of them either at a profit or loss. . . .*" (Emphasis supplied)

In the dissent in the instant case, Judge Hutcheson said at R. 194, Appendix B, infra p. 53:

> "The taxpayer in the Cluett case was certainly not in the business of selling stock exchange seats, and Mr. Campbell was not in the business of selling coal companies. Yet the government contends, and the tax court and the majority have erroneously held, that in order for the loss to be deductible, taxpayer Whipple must show that the numerous corporate enterprises which he promoted, financed, and managed were formed by him for sale."

The Cluett and Campbell cases referred to by Judge Hutcheson were tax court cases,[1] but they have been followed by Courts of Appeal and by the Court of Claims in the following cases: *Mays v. Commissioner*, (6th Cir.), 272 F. 2d 788, 60-1 USTC 9122, *Commissioner v. Stokes' Estate*, (3rd Cir.) 200 F. 2d 637, 53-1 USTC 9164, *Maytag v. United States*, U.S. Court of Claims, 289 F. 2d 647, 61-1 USTC 9424.

In all of the above cases and in the case of *Foss v. Commissioner* (1st Cir.), 76 F. 2d 326, 35-1 USTC 9091 a business bad debt loss was allowed, but in none of them did the taxpayer show any evidence whatever of having formed corporations for sale, or in fact of having sold them.

2. Another conflict appears where the majority of the Court in the instant case went on to state at R. 187, Appendix B, infra p. 46:

> "We think that the tax court was amply warranted in finding that there was no evidence in this record other than the simple fact that the taxpayer had used his talents as a building contractor to organize a large number of companies to conduct such building

[1] **Robert Cluett 3rd v. Commissioner**, 8 TC 1178 (1947) Acq. 1947-2 CB.; **Vincent C. Campbell v. Commissioner**, 11 TC 510 (1948), Acq. 1949-1 CB.

> operations, that he was interested in any way in doing any more than enabling these separate corporations to achieve a successful and lucrative operation as corporations. Taxpayer's claim, it seems clear to us, falls within the class of those who fail to recognize the distinction between carrying on one's business through a corporate form, which of course, requires some organizing and financing, and the business of dealing in corporations, which may likewise require some financing arrangements."

In the dissent at R. 195, Appendix B, infra p. 54, Judge Hutcheson comments on this as follows:

> "It seems to me that the basic fault of the majority opinion is in holding, as it in effect does, that business bad debt treatment must be denied the taxpayer here because the loan was to a corporation in which he was interested. This holding is, in my opinion, a clear addition to the taxing statute. If congress had so intended, it could and would have so provided. Not having done so, neither the tax court nor this court can construe the statute as though it contained such provision."

This holding of the majority in the instant case is clearly in conflict with the majority of the Court in the case of *Maytag et al v. United States* (U.S. Court of Claims) 289 F. 2d 647, 61-1 USTC 9424, which allowed the taxpayer's business bad debt claim.[2] In that case the loss was suffered as the result of a bad debt of Maytag-Waynich, Inc., a corporation organized in 1951

[2]Decisions of Courts of Appeal in conflict with Court of Claims holdings are treated the same as conflicts with other Courts of Appeals. **Helvering v. Inter-Mountain Life Insurance Co.**, 294 U.S. 686, 689, 79 L.Ed. 1229.

to conduct one part of the taxpayer's general business of carrying on activities connected with the airplane industry. Prior to 1951 he had conducted such activities as a sole proprietorship.

The Court stated:

> "His reasons for incorporating the business were natural ones: the avoidance of personal liability in a hazardous business; the simplication of records; the possibility of getting additional capital from the outside * * *"

In reaching its decision the Court in the Maytag case stated:

> "If he had carried on all of these activities as an individual proprietor, as indeed he did carry on most of them for several years, he could without a question have included the successes and failures of all the separate branches of his business in the computation of his income. Our conclusion is that these activities were his business, and the bad debt which he seeks to deduct was a business bad debt * * * *It would be hard to imagine a loss more 'proximate' to that business activity than the uncollectibility of a loan made to it to promote its well being.*" (Emphasis supplied)

The Court went on to say:

> "What the government urges, as we see it, is that if one embodies his business in the corporate form, he may *in fact* spend his days in overalls working at a bench in his factory, but *in law* he will be regarded as engaging only in cashing dividend checks and clipping coupons. We see no reason to engage in such make believe."

The Court continued, very much as did the dissenting judge in the instant case, and stated:

> "If the lawmakers had intended to draw the line at the corporate form of business, they would have said so. If they had said anything susceptible of being interpreted to mean that, the Treasury in its regulations would have said so."

3. The holding of the majority of the Court of Appeals for the Fifth Circuit in the instant case is also in conflict with *Maloney v. Spencer* (9th Cir.) 172 F. 2d 638, 49-1 USTC 9176, a decision by the Ninth Circuit in which the facts were quite similar to those of Petitioner A. J. Whipple.

In their Petition for Review and Assignment of Error Petitioners A. J. and Mildred Whipple's fourth assignment of error was as follows:

> "4. The Tax Court of the United States erred in failing to make any finding as to petitioners' contention that petitioner, A. J. Whipple, was in the business of acquiring, owning, expanding, equipping and leasing bottling plants and other equipment, out of the conduct of which business the $56,975.10 bad debt loss resulted in the calendar year of 1953."

The parallel between the instant case and the *Spencer* case is apparent when the following is considered:

> (a) In the *Spencer* case the taxpayer organized three fruit, berry and vegetable packing and canning and dehydrating corporations, owned almost entirely by taxpayer, which operations were previously conducted by taxpayer individually.

1.(b) In the instant case Petitioner organized a soft drink bottling corporation and later a soft drink distributorship corporation, and a soft drink vending machine business. Petitioner was the controlling and dominant owner of all three of these and furnished the equipment for the bottling operation.

2.(a). In the *Spencer* case, to further equip one plant the taxpayer bought adjoining land, and erected building equipped for canning, and leased it to the cannery corporations.

2.(b). In the instant case Petitioner bought land in the same city and erected buildings on it, equipped for bottling soft drinks, which he leased to the bottling corporation.

3.(a). In the *Spencer* case the taxpayer agreed as part of the lease to provide adequate financing for the cannery business.

3.(b). When Petitioner built his building for the bottling plant he was already providing the bottling corporation with financing, having advanced $69,-002.50, and it was implicit in the lease that he would continue to do so, which he did, in the amount of an additional $62,775.75.

The Court in the *Spencer* case held that the taxpayer was engaged in the business of "acquiring, owning, expanding, equipping and leasing food processing plants". The facts are even stronger in the instant case for the finding that Petitioner was in the business of acquiring, owning, expanding, equipping and leasing a bottling plant and other businesses. Petitioner was in the rental business aside from these bottling enterprises. He had twice bought premises and equipped them for lumber yards, and was all throughout 1951-53 leasing land and buildings to

Whipple Lumber Co. He also had a rent house and had formed an equipment rental corporation to lease equipment to lumber yards and construction companies.

Therefore, within the rule of the *Spencer* case it would seem clear that Petitioner was in the business of acquiring, owning, expanding, equipping and financing a bottling plant and other businesses.

By refusing to make any holding on this assignment of error the Court of Appeals for the Fifth Circuit rejected the rule laid down in the case of *Maloney v. Spencer* (supra) and its decision is therefore in conflict with that decision of the Ninth Circuit.

B. IMPORTANCE

The importance of this case, not only to this taxpayer, but to the many other taxpayers similarly situated and the Courts, may first be emphasized by looking at the number of decisions which have dealt with the questions presented here. C.C.H. Tax Service reports that there were 192 cases involving the point which have been reported since Section 23 (k) (4) was enacted in 1942. In the past two years four Circuit Courts of Appeals and the Court of Claims have reported cases involving the question here under consideration. On varying fact situations, the Second Circuit in *Trent v. Commissioner*, 291 F. 2d 669, 61-2 U.S.T.C. 9506, the Fourth Circuit in *Rollins v. Commissioner*, 276 F. 2d 368, 60-1 U.S.T.C. 9357, the Fifth Circuit in this case below, the Sixth Circuit in *Mays v. Commissioner*, 272 F. 2d 788 60-1 U.S.T.C. 9122, and the Court of Claims in *Maytag v. United States*, 289 F. 2d 647, 61-1 U.S.T.C. 9424, each were forced to a contemplation of the varying and conflicting holdings of prior courts in

defining what constitutes a trade or business within Section 23 (k) (1) of the *Internal Revenue Code* of 1939 and its successor Section 166 (d) of the *Internal Revenue Code* of 1954.

In the words of one text writer: "The distinction between business and non-business debts has induced a confusing array of cases." (Rabkin & Johnson, *Federal Income, Gift & Estate Taxation*, § 35.01 (4)).

The courts have recognized the problem and their comments are informative. The Court of Appeals for the Sixth Circuit in the case of *Mays v. Commissioner*, 272 F. 2d 788, 60-1 U.S.T.C. 9122 said:

> "The issue of fact in each particular case is whether the loss is incidental to and proximately related to the taxpayer's trade or business. This determination is made difficult, for the reason that the code, the regulations and the decisions fail to define satisfactorily the term 'trade or business'."

Similarly, the Court said in *Trent v. Commissioner*, 2nd Cir., 291 F. 2d 669, 61-2 U.S.T.C. 9506:

> "Hence, if we were reading from a slate clean save for this statute, we would arrive swiftly at a holding (in favor of the taxpayer) * * * However, there is much other writing on the slate; we must determine whether it calls for reading the words of Section 166 (d) (2a) differently from what their sense would seem to be."

The dissent in the Court below in the same vein pointed out at R. 194, Appendix B, infra p. 53:

> "Yet the government contends, and the Tax Court and the majority have erroneously held, that in order

> for a loss to be deductible, taxpayer Whipple must show that the numerous corporate enterprises which he promoted, financed and managed, were formed by him for sale. This extension of the restriction on the qualification of business bad debts contended for by the Commissioner and the Tax Court considerably restricts the remedy which Congress provided for curing the mischief it had in mind. I think it clear that such restriction was never contemplated by Congress. Indeed the contention pressed here emasculates a clearly intended remedial law.
>
> "Looking at the question in the light of the language of the act and its legislative history, I am in no doubt that the Tax Court was wrong in citing and relying on cases to the contrary of these views for such a restrictive and defeating construction."

A decision by the Supreme Court in this case would clarify the definition of "trade or business" intended under the statute allowing the Tax Court, the District Courts, the Courts of Appeal, numerous taxpayers and the Commissioner to apply the definition to a particular situation with a degree of certainty now impossible because of the confused condition of the Law. Thus much litigation could be avoided which is not only expensive for both taxpayers and the government but which is consuming a vast amount of the time of the Federal Courts.

C. ERROR OF COURT BELOW

1. The majority of the Court of Appeals for the Fifth Circuit erred in the instant case in holding that the taxpayer in order to deduct as a business bad debt one of many loans made in the course of organizing, financing and operating numerous corporations, must also prove that he was a person who had formed the corporations for the purpose of selling them.

Petitioner submits that this is error as a matter of law, and cites as authority the following cases in which a business bad debt loss was allowed a taxpayer who showed no evidence whatever of having formed corporations for sale. *Foss v. Commissioner of Internal Revenue* (1st Cir.), 76 F. 2d 326, 35-1 USTC 9091; *Campbell v. Commissioner*, 11 T.C. 510 (1948); *Commissioner v. Stokes' Estate* (3rd Cir.), 200 F. 2d 637, 53-1 USTC 9164; *Henry E. Sage v. Commissioner*, 15 T.C. 299; *Charles H. Scott v. Commissioner*, 14 T.C.M. 1029; and the recent cases of *B. A. Mays v. Commissioner of Internal Revenue* (6th Cir.), 272 F. 2d 788, 12/14/59, 60-1 USTC 9122, reversing 17 T.C. 773, and *L. B. Maytag, Jr. v. United States*, U. S. Court of Claims 5/3/61, 289 F. 2d 647, 61-1 USTC 9424.

2. The majority of the Court erred in holding that the $56,975.10 bad debt incurred by Petitioner, A. J. Whipple, which had resulted from his broad activities as the holder of a bottling franchise, the builder and lessor of the buildings in which the bottling plant was carried on, the owner of the bottling equipment, the manager as well as President and controlling stockholder of the bottling corporation, the controlling owner and operator of two other related soft drink businesses was not a business bad debt because the loans which were the basis of the $56,975.10 bad debt were made to a corporation in which Petitioner was interested. Numerous decisions have held against such a limitation on the business bad debt treatment of a loan.[3]

[3]The following leading cases allowing taxpayer business bad debt treatment involved loans to corporations in which taxpayer was a substantial stockholder. **Campbell v. Commissioner**, 11 T.C. 510; **Commissioner v. Stokes' Estate** (3 Cir.), 200 F.2d 637; **Maloney v. Spencer** (9 Cir.), 172 F.2d 638; **Foss v. Commissioner** (1 Cir.), 75 F.2d 682; **B. A. Mays v. Commissioner** (6 Cir.), 272 F.2d 788, 60-1 USTC, 9122, reversing 17 T.C. 773; **L. B. Maytag, Jr. v. U. S.** (U. S. Court of Claims), 289 F.2d 647; 61-1 U. S. Tax Cases 9424.

3. The majority of the Court of Appeals for the Fifth Circuit erred in failing to make any ruling on the fourth point urged by Petitioners in their Petition for Review and Assignments of Error which read as follows:

> "The Tax Court of the United States erred in failing to make any finding as to petitioners' contention that Petitioner, A. J. Whipple was in the business of acquiring, owning, expanding, equipping and leasing bottling plants and other equipment out of the conduct of which business the $56,975.10 bad debt loss resulted in the calendar year 1953."

As pointed out in detail in showing the conflicts between the decision of the Court of Appeals for the Fifth Circuit in the case below and cases in other circuits, the facts of the instant case brought it within the rule of *Maloney v. Spencer* (9th Cir.), 172 F. 2d 638, 49-1 USTC 9176, a case in which a business bad debt was allowed the owner, expander, equipper and lessor of canning plants. Under the doctrine of that case, Petitioner, A. J. Whipple, should have been allowed the same treatment, and it was error not to treat his $56,975.10 loss as a business bad debt.

4. The majority of the Court of Appeals for the Fifth Circuit erred in holding that the $56,975.10 bad debt incurred in Petitioner A. J. Whipple's extensive activities[4] of financing and making loans to corporations, partnerships

[4]Petitioners' income tax returns show that Petitioner, A. J. Whipple, received interest from a total of 34 parties during the years 1951 through 1953 and reported as ordinary income the receipt of $1,680.15 in 1951, $2,307.35 in 1952, and $1,747.59 in 1953 (Exhibits 12-L, 13-4, 20-T). Total loans in the amount of $131,788.26 were made to Mission Orange Bottling Company of Lubbock through July 1, 1951 to December 15, 1953 (R. 102) and a $25,000 to $30,000 advance was made to Angleton Building & Homes Corp. in 1953 (R. 161).

and individuals could not be a business bad debt because Petitioner was not in the *separate* business of lending money. No authority is cited for such a ruling. The case of *Charles H. Scott v. Commissioner*, 14 T.C.M. 1029, is clear authority for just the opposite.

In that case twelve enterprises were mentioned in the stipulation which the taxpayer, Scott, had been instrumental in organizing. He had loaned money to six. To six he had not. He was sole owner, an officer, or a director of all of them and took an active part in their activities.

The Court held:

> "The loans were business as opposed to non-business bad debts. Henry E. Sage, 15 T.C. 299; Vincent C. Campbell, 11 T.C. 510; Maloney v. Spencer, 172 F. 2d 638."

In none of these cases was the taxpayer in the separate business of lending money.

5. The majority of the Court of Appeals perpetuated the error of the Tax Court by failing to make any finding as to whether a *combination* of Petitioner's activities constituted a business to which the $56,975.10 bad debt loss sustained in 1953 was proximately related, although this was specifically stated as Petitioners' Fifth Assignment of Error.

Instead the Court segregated Petitioners' activities into three lines of endeavor, narrowly considered each of them separately, and then one by one concluded that Petitioner was not in that *particular* business.

The Court completely ignored Petitioner's contention that the $56,975.10 bad debt loss proximately resulted from a combination of A. J. Whipple's activities as organizer, owner, financer, lessor, officer, manager and soft

drink franchise holder, which combination generated $95,950.14 of ordinary income in the years 1951-52.[5]

It is respectfully submitted that a debt arising from such activities was clearly a business bad debt within the meaning of Section 23 (k) (1) IRC 1939. *Maytag, et al. v. United States,* 289 F. 2d 647, U.S.C.C. 61-1 USTC 9424; *Mays v. Commissioner,* 272 F. 2d 788, (6 Cir.) 60-1 USTC 9122; *Sage v. Commissioner,* 15 T.C. 299.

Perhaps the Court in the *Sage* case, (supra) best described the type of activities which, though hard to classify, in combination constitute a business. At page 303 the Court said:

> *"Some of his activities may appear trivial and it may be inappropriate to fit some of the uses to which he put his time or money or both into the pattern of any business regularly carried on by him.* But even if some

[5]It was stipulated in the Tax Court as follows (R. 60-61): "23. On March 18, 1953, petitioners filed a joint individual income tax return, Form 1040, for the taxable year 1952. Photostat thereof is hereto attached, marked Exhibit 13-M, and made a part hereof, showing income from the following sources:

Form No.	Company	Exhibit No.
W-2	Whipple Lumber Company	13-M1
W-2	Whipple Construction Company	13-M2
W-2	Whipple Equipment Co., Inc.	13-M3
W-2	Angelton Homes Corp.	13-M4
W-2	Dozier-Whipple Const. Corp.	13-M5
1099	Federated Department Stores, Inc.	13-M6
1099	Durham-Clark Building Supply Co.	13-M7
1099	Whipple Lumber Company	13-M8

Interest received from 14 corporations, partnerships, and corporations:
Restaurant
Partnership
Lee County Oil Lease
Rent House Houston
Rental Building in Lubbock."

are disregarded, enough are left to show that he was regularly carrying on a business. *There may be difficulty or difference of opinion in defining that business properly, but it existed and was apparent.* * * *" (Emphasis supplied).

6. The majority of the Court of Appeals for the Fifth Circuit erred in relying on the confused interpretation put on the statute by decisions which have construed the statute so narrowly as practically to defeat its remedial purpose, rather than relying on the language of the legislative history and treasury regulations[6] pertaining to the statute.

As pointed out by Judge Hutcheson in his dissent in the decision below at R. 191, Appendix B, infra p. 50:

> "The language of the act and its legislative history both show that congress, desiring to encourage risk taking with respect to loans incurred in connection with business and to discourage the making of loans for use taxwise to kinsmen or friends, gave favorable tax treatment to bad debts arising out of, or in connection with business ventures, while denying such treatment to purely personal bad debts or those where other than business considerations motivated the lend-

[6]Section 39.23 (k)-6, Income Tax Regulations, Internal Revenue Code, 1939:

> "(b) The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a nonbusiness debt for the purposes of this section."

> ing. I think that the purpose of the statute was, and is, not advanced and the remedy is completely defeated when the mischief the statute was designated to meet is dropped entirely out of the consideration, as in the board's decision here, in some of the decisions the board relies on, and in the majority opinion."

7. The majority of the Court of Appeals below erred in basing its decision, in part, on conclusions in direct opposition to the stipulations of fact in the Tax Court.

The majority of the Court cast doubt as to whether $48,000 of the $56,975.10 loss was actually a bad debt by saying at R. 184, Appendix B, infra p. 43:

> "Thus it appears that at the time when the sum of $48,000 of the indebtedness in issue was advanced to Mission Orange petitioner had no hope of its being recovered."

The conclusion drawn by the majority of the Court below goes behind and is directly contrary to Stipulation No. 7 in the Tax Court which was as follows (R. 56):

> "That as of December 31, 1953, Mission Orange Bottling Co. of Lubbock, Inc., was indebted to Petitioner, A. J. Whipple, in the amount of $56,975.10, and that such debt had become worthless in 1953, and the sole issue remaining as to said sum of $56,975.10 is whether said sum is a business bad debt or a non-business bad debt within the meaning of Section 23 (k) (1) or Section 23 (k) (4), respectively, Internal Revenue Code of 1939."

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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It is hereby certified that a copy of the above and foregoing Petition For A Writ Of Certiorari to the United States Court of Appeals For The Fifth Circuit was served on each of the following by depositing the same in a United States post office, air mail postage prepaid, this _____ day of August, 1962:

(1) Solicitor General
Department of Justice
Washington 25, D. C.

(2) Louis F. Oberdorfer
Assistant Attorney General
Tax Division
Department of Justice
Washington N. W., D. C.

Of Counsel for petitioner

APPENDIX A

Section 23(k)(1) of Internal Revenue Code, 1939

(k) Bad Debts

(1) General Rule—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection. In the case of a mutual savings bank not having capital stock represented by share, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit, the reasonable addition to a reserve for bad debts shall be determined with due regard to the amount of the taxpayer's surplus or bad debt reserves existing at the close of December 31, 1951. In the case of a taxpayer described in the preceding sentence, the reasonable addition to a reserve for bad debts for any taxable year shall in no case be less than the amount determined by the taxpayer as the reasonable addition for such year; except that the amount determined by the taxpayer under this sentence shall not be greater than the lesser of (A) the amount of its net income for the taxable year, computed without regard to this subsection, or (B) the amount by which 12 per centum of the total deposits or withdrawable accounts of its depositors at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year.

Section 23(k)(4) of Internal Revenue Code, 1939

(4) Non-Business Debts -- In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

Section 39.23(k)-6, Income Tax Regulations, Internal Revenue Code, 1939

Nonbusiness bad debts

(a) In the case of a taxpayer, other than a corporation, if a nonbusiness bad debt becomes entirely worthless within the taxable year, the loss resulting therefrom shall be treated as a loss from the sale or exchange of a capital asset held for not more than six months. Such a loss is subject to the limitations provided in section 117 with respect to gains and losses from the sale and exchange of capital assets. A loss with respect to such debt will be treated as sustained only if and when the debt has become totally worthless, and no deduction shall be allowed for a nonbusiness debt which is recoverable in part during the taxable year. Nor are the provisions of this section applicable in the case of a loss resulting from a security as defined in section 23 (k) (3). A non-business debt is a debt, other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business and other than a debt evidenced by a security as that term is defined in section 23(k)(3). The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case. The determination of this

question is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23(e) is "incurred in trade or business" under section 23(e)(1).

(b) The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a nonbusiness debt for the purposes of this section.

APPENDIX B

MEMORANDUM FINDINGS OF FACT AND OPINION.

Filed February 29, 1960.

T. C. Memo. 1960-36.

Tax Court of the United States

A. J. Whipple and Mildred Whipple, Petitioners,

v. Docket No. 65603.

Commissioner of Internal Revenue, Respondent.

Ben H. Schleider, Jr., Esq., and Charles Dillingham, Esq., for the petitioners.
D. Louis Bergeron, Esq., for the respondent.

Opper, Judge: Respondent determined deficiencies in petitioners' income tax and in additions to tax for the years 1952 and 1953 as follows:

Year	Income Tax	Sec. 294[1] (d) (1) (A)	Sec. 294 (d) (1) (B)	Sec. 294 (d) (2)
1952	$ 297.04	$2,664.07	—0—	$1,776.04
1953	17,625.78	1,326.54	$804.00	248.29

The issues to be decided are (1) whether a $56,975.10 debt owed to petitioners in 1953 which became uncol-

[1]All section references are to the Internal Revenue Code of 1939.

lectible in that year was a business or nonbusiness bad debt within the meaning of section 23 (k), and (2) whether $3,349.50, paid by petitioners in 1953 to D. M. Dozier, is a deductible business expense or a capital expenditure. Petitioners abandoned, on brief, all alleged errors in regard to the imposition of additions to tax under section 294(d), except as to the correct amount of additions to tax due for 1953 under section 294 (d) (1) (A) which may be resolved in accordance with Rule 50 after we dispose of the major issues presented for our decision. Other issues raised by the pleadings have either been conceded or resolved by stipulation.

Findings of Fact.

The stipulated facts are found.

A. J. Whipple, hereafter called petitioner, and Mildred Whipple are husband and wife and reside in Houston, Texas. They filed their joint income tax returns for 1952 and 1953 with the district director of internal revenue at Austin, Texas.

Petitioner, prior to 1941, was a construction superintendent and an estimator for a lumber company. In 1941, and for about a year thereafter, he and W. E. Brown were partners in the construction of houses and homes.

Around 1942 petitioner, Miles Strickland and W. C. Perkins formed the S.W.P. Construction Company, a partnership organized to build houses. Perkins later withdrew from this venture and the partnership became known as S. & W. Construction Company. At some time

subsequent to 1942, petitioner and Strickland formed the following partnerships: Evergreen-Rice Company, a construction company; Airline Lumber and Supply Company, Ltd., of which John W. Anderson was also a partner; Shakertown Distributors, formed, with Anderson, to distribute shingles; Gulf Coast Plumbing and Supply Company; and State Tile Distributors, a wholesale tile company which resulted from petitioner's informal negotiations to purchase 4 carloads of tile.

During the years 1949 and 1950, petitioner was an original incorporator of 7 corporations, as follows: Federal Road Building Corporation; Richmond Plaza, Inc.; Strickland-Whipple Construction Company, Inc., a successor to the partnership S. & W. Construction Company; Airline Lumber and Supply Company, Inc., a successor to the partnership, Airline Lumber and Supply Company, Ltd.; Dorwayne Construction Corporation; 29th and Airline, Inc., a real estate rental corporation which owned and rented the property occupied by Airline Lumber and Supply Company, Inc., and Shakertown Distributors; and Federal Road Lumber Company, Inc.

In 1951 petitioner sold his interest in the 7 above-named corporations and in Shakertown Distributors to Miles Strickland. During the same year he sold to Strickland his equity in 5 other corporations. In his 1951 income tax return, petitioner reported this sale as relating to property he acquired in 1949. These 5 corporations, namely, Industrial Homes, Inc., Harbor Homes, Inc., Commonwealth and California Corporation, Commonwealth and Missouri Corporation, and Riverside Apart-

ments Corporation, were in the rental housing or construction business. All of these sales resulted in gain to petitioner which he reported on his 1951 return as long-term capital gain.

In 1951 petitioner purchased the land and improvements located at 2436 Bissonnet Street, Houston, Texas, as the location for various construction businesses and other enterprises. He formed the A. J. Whipple Construction Company, which was a partnership of petitioner, V. L. Yarborough, Leonard Olive and G. A. Durham. This partnership was later succeeded by another partnership, A. J. Whipple Construction Co. No. 2.

During the years 1951 and 1952, petitioner was an original incorporator of 8 corporations, as follows: Whipple Lumber Company; Whipple Equipment Co., Inc., which engaged in the business of renting automobiles, trucks and construction equipment; Dozier-Whipple Construction Corporation; Chevy Chase Development Corporation; Whipple Construction Co., Inc.; Angelton Homes Corporation; Angelton Building & Holding Corp.; and Mission Orange Bottling Co. of Lubbock, Inc., hereafter called Mission Orange. During 1952 and 1953, petitioner received salaries totaling $29,400 and $33,450, respectively, from some of the construction corporations.

Petitioner acquired land in Pasadena, Angelton, Bellaire and Houston, Texas, and engaged in sales activities with respect to such lands during 1951 through 1953. He purchased a restaurant in Houston and sold it to Guy Francis on June 1, 1953. At some time he engaged in several oil ventures.

On April 17, 1951, petitioner acquired an option to purchase the Mission Orange Bottling Co., a sole proprietorship owned by D. C. Casey. On April 21, 1951, petitioner, as lessee, rented the premises occupied by Casey's business for 20 months, effective May 1, 1951, for $150 per month. On April 25, 1951, petitioner obtained a franchise from the Mission Dry Corporation entitling him to produce, bottle, distribute, and sell Mission beverages in certain counties in Texas. On April 27, 1951, petitioner purchased the bottling machinery and equipment from Casey for $46,225. He conducted this business as a sole proprietorship under the name Mission Orange Bottling Co. until approximately July 1, 1951, when he sold the bottling machinery and equipment to Mission Orange. He did not transfer the franchise to Mission Orange.

Mission Orange was organized under the laws of Texas on June 8, 1951, with an authorized capital stock of $20,000, of which amount $10,000 or 100 shares, par value of $100 each, were subscribed to and paid for by the following persons:

Shareholder	Office Held	Shares	Par Value
Petitioner	President	88	$ 8,800
James A. Finley	Vice President	10	1,000
Charles Dillingham	Secretary	2	200
Total		100	$10,000

The charter of Mission Orange was amended on December 8, 1952 to increase the authorized capital stock to $40,000. Thereafter the issued and outstanding stock was held as follows:

Shareholder	Shares	Per cent	Par Value
Petitioner	308	77.	$30,800
James A. Finley	10	2.5	1,000
Charles Dillingham	2	.5	200
Cecil Clark	20	5.	2,000
Dora B. Ellzey	10	2.5	1,000
D. M. Dozier	10	2.5	1,000
Jack Knostman	20	5.	2,000
James F. Webster	20	5.	2,000
Total	400	100.	$40,000

Sometime prior to the end of 1953, petitioner increased his holding to 318 shares, which was 79.5 per cent of those outstanding and represented an investment of $31,800.

In 1952 petitioner erected a bottling plant on land which he purchased in Lubbock, Texas. The land and building cost a total of $43,601.70. On July 14, 1952, petitioner leased this plant to Mission Orange for a 10-year term, beginning August 1, 1952, with an option to renew. The prescribed rental was $500 per month for the first 3 years and $500 per month plus 1 per cent of gross sales thereafter. In his 1952 and 1953 return, petitioner claimed a deduction for depreciation of the bottling plant in Lubbock. These returns reflect that petitioner received no rent during either year for that building.

Petitioner, directly or indirectly, made cash advances to Mission Orange of $48,550 in 1952 and $6,750 in 1953. He paid Mission Orange's expenses amounting to $2,975.76 during the years 1951 through 1953 and re-

ceived refunds and credits totaling $4,388.50. The balance due to petitioner by Mission Orange on December 1, 1953, including the amount of $25,502.50 owed him as the result of his sale of the bottling assets to the corporation in July 1951, was $79,489.76.

On December 15, 1953, petitioner advanced Mission Orange $48,000 to pay general creditors and on the same date received a transfer from Mission Orange of bottling machinery, equipment and an automobile which had a total book value of $70,414.66. The net amount due by Mission Orange to petitioner on December 31, 1953 was $56,975.10. This debt became worthless in 1953.

On September 1, 1951, petitioner acquired stock of a corporation known as Mason Root Beer. This corporation owned a franchise to bottle and sell Mason root beer in Amarillo, Texas. The root beer was bottled at the Mission Orange plant in Lubbock. Mason Root Beer failed in 1953 and petitioner's return for that year reflects a $3,300 loss on his stock in that corporation and a nonbusiness bad debt due from that corporation of $53.33.

Petitioner had a vending machine arrangement with Ideal, Indiana, which sold vending machines to the trade. Mission Orange had no interest in this venture.

Petitioner made loans to his various corporations, partnerships, fellow shareholders and partners throughout the years in issue. His income tax returns for 1951, 1952 and 1953 reflect interest income as follows:

Payor	1951	1952	1953
Whipple Lumber Co., Inc.	$ 19.35	$ 868.51	$1,047.38
Dozier-Whipple Construction Corp.	61.42	393.89	—
Whipple Construction Co., Inc.	130.68	5.61	—
Angleton Homes Corp.	391.98	—	—
A. J. Whipple Construction Co.	4.92	44.28	—
Cecil Clark	70.56	45.61	—
D. M. Dozier	70.56	45.61	—
G. A. Durham	86.98	74.33	—
J. A. Finley	64.46	—	—
Whipple Equipment Co., Inc.	591.89	575.51	37.82
Willard Evans	70.56	45.61	—
Dora Ellzey	70.56	45.61	—
L. R. Olive	24.99	4.76	—
Durham-Clark Building Supply Co.	9.24	57.95	—
W. N. Atkins	20.81	*(20.81)	—
Roy J. Pate	1.19	*(1.19)	—
Harland Miller	—	47.00	—
The Brag Club, Inc.	—	53.07	19.16
Guy Francis—Guy's Restaurant	—	—	643.23
Total Interest Income	**$ 1,680.15	$ 2,285.35	$ 1,747.59

* Interest accrued and unpaid in 1951.

**The correct total is $1,690.15.

Petitioner deducted the debt due from Mission Orange on his 1953 return as a business bad debt. Petitioner was not in the business of organizing, promoting, managing or financing corporations in 1953. He was not in the business of lending money in that year.

In his return for 1953, petitioner deducted $3,349.50 as "commissions" paid to D. M. Dozier. Respondent determined that this payment "constitutes part of the cost of acquiring land * * * in 1952 and sold during 1953 * * *." $3,349.50 was entered on petitioner's records as a part of the costs of the purchase of the Westheimer tract, which petitioner purchased on April 3, 1952 for $583,181.47 and sold in 1953 for $672,282.00. At some later time, $3,349.50 was credited on petitioner's records to the Westheimer tract and charged as a direct expense. Petitioner hired Dozier in 1951, agreeing to pay him a salary, expenses and 15 per cent of profits of all joint ventures, partnerships and individual land deals in which petitioner had an interest, except Whipple Lumber Company. Dozier left petitioner's employ in February 1953 before the sale of the Westheimer tract and was paid approximately $29,000 for his share of profits, both realized and anticipated. The $3,349.50 in dispute was included in the foregoing payment. That amount is 15 per cent of the profits anticipated to be realized from the sale of the Westheimer tract.

Petitioner failed to file a declaration of estimated tax for 1952. It is stipulated that he filed such a declaration for 1953 on January 14, 1954.

OPINION

The primary issue here is one that is frequently before this Court. Petitioner, through guarantees or outright

loans, advanced substantial sums to a corporation which he controlled. Later developments proved his investment unfortunate and he is here claiming that his uncollectible advances arose out of his trade or business and that he should be permitted to deduct them in full and without regard to the limitations imposed on nonbusiness bad debts by section 23 (k) (4).

Petitioner would have us find a proximate relationship between the loss occasioned by the worthlessness of the debt due from Mission Orange and any one of three businesses in which he alleges he was individually engaged at the time of the loss. He contends that he was in the business of organizing, promoting, managing and financing corporations, general financing and lending of money, operating a bottling business, or all three.

Looking first to petitioner's alleged promotional activities, it is apparent that he was instrumental in incorporating 15 corporations over a period of less than 4 years, commencing in 1949. Fourteen of these corporations were engaged in the construction, building or real estate business. Petitioner owned stock in 5 additional construction or real estate corporations and at one time or another was a member of 10 partnerships involved in similar activities. Individually, petitioner was in the construction or real estate business.

What petitioner fails to recognize is the distinction between carrying on one's business through a corporate form, which, of course, requires some organizing and financing, and the business of dealing in corporations, which may likewise require some financing arrangements. [Holtz v. Commissioner, (C.A. 9) 256 F. 2d 865, 870, affirming T.C. Memo. 1957-106.]

His purpose in forming the 14 corporations was to facilitate his construction or real estate business and not to de-

velop them for sale as going businesses to customers in the course of the business of promoting. H. Beale Rollins, 32 T.C. 604, 615. Petitioner apparently entertained that opinion himself in the year 1951 when in his return for that year he reported the sale of 12 corporations and 1 partnership as the sale of capital assets. See Thomas Reed Vreeland, 31 T.C. 78. The evidence does not show that petitioner's business in 1953 was any different from 1951.

Petitioner invites our attention to his 1951, 1952 and 1953 returns to substantiate his claim that he was in the business of lending money. In 1951 he reported the receipt of $1,680.15 as interest from 16 corporations, partnerships or individuals; $1,200.24 of this sum was interest received from his construction corporations or partnerships. In 1952 he reported the receipt of $2,307.35 as interest from 14 corporations, partnerships or individuals; $1,887.80 of this sum was interest received from his construction corporations or partnerships. In 1953, $1,747.59 was reported as interest received from 4 corporations or individuals and $1,085.20 of this amount was received from 2 of his construction corporations. Some of the other amounts were trivial, such as $9.24 and $1.19 received from Durham-Clark Building Supply Company and Roy J. Pate, respectively, in 1951, and $4.76 received from L. R. Olive in 1952. It therefore appears that the bulk of petitioner's loans went to corporations and partnerships in which he had an investment and we cannot find that the purpose of these loans was other than to protect that investment. Such lending activity does not constitute a trade or business. Holtz v. Commissioner, supra.

The remaining loans reflected by petitioner's interest receipts were, to a large extent, made to fellow shareholders and partners. We cannot find that lending activity of this

nature constitutes trade or business. However, even if we were to find otherwise, there is no evidence that the advances made to Mission Orange were made as a part of that business. Petitioner received intermittent payments from Mission Orange, admittedly small in amount, but he reflected no amount as having been received as interest and there is no evidence that that corporation agreed or was obligated to pay interest. Without interest petitioner stood to make no profit on the loan, and if there is no prospect of profit there is no trade or business. Thacher v. Lowe, (S.D.N.Y.) 288 F. 994.

Petitioner's contention that he was in the bottling business when the debt in question became worthless is without evidentiary support for two reasons. First, petitioner would have us find that he was in the bottling business from December 15 through December 31, 1953 because he was "the dominant stockholder of Masons Root Beer, a participant in soft drink vending machine business, the President of Mission Orange Bottling Co., Inc., the holder of 79% of its stock, the owner of the building in which the bottling plant was located, the holder of the bottling franchise, the owner of the bottling machinery and equipment, [and] the plant manager." Petitioner's relation to Mason Root Beer and Mission Orange as a shareholder, officer or employee does not place him in the business in which the corporations were engaged. Burnet v. Clark, 287 U.S. 410. Although it appears that petitioner had sufficient assets subsequent to December 15, 1953 to engage individually in the bottling business, there is no evidence that he did so; and the mere ownership of these assets does not put him in the bottling business.

The second fault we find with petitioner's contention is that the stipulated date of worthlessness of the debt is

the year 1953 and there is nothing in the record which might support petitioner's allegation of a more specific date, that is December 31, 1953. If we were required to find a definite time of worthlessness, we should be inclined to select December 15, 1953, at which time petitioner received the bottling assets from Mission Orange in partial satisfaction of that corporation's obligation. At this point petitioner was not in the bottling business. It may be, moreover, that any debt arising at that time was worthless when acquired.

Even if we assume that the debt became worthless subsequent to December 15 and at a time when petitioner was in the bottling business, petitioner must still show us the proximate relationship between his business and the bad debt loss. Jan G. J. Boissevain, 17 T.C. 325. We have been unable to ascertain any proximate relationship between the debt owed by Mission Orange, a corporation no longer in the bottling business, and petitioner's alleged business of bottling soft drinks, and petitioner has pointed out none. A more realistic description of that payment might be an exchange or purchase of corporate assets.

The bad debt losses in question were not incurred in any trade or business conducted by petitioner. They are nonbusiness bad debts and accordingly are to be treated as short-term capital losses. Section 23 (k) (4).

The evidence submitted in regard to the second issue is vague and indefinite. Petitioner contends that he paid D. M. Dozier $3,349.50 under a contract of employment. The amount in controversy is claimed to have been but a part of a larger sum paid by check to Dozier. Although the testimony is slight, there is no contrary evidence, and on the strength of petitioner's statements under oath, we accept his version that the payments were ordinary and

necessary as compensation for contributing services and not a part of a commission on the purchase of specific property.

The final issue concerns additions to tax relating to declarations of estimated tax. The briefs in this case were filed before the Supreme Court handed down its decision in Commissioner v. Acker, 361 U.S. 87. It was held in that case that the additions to tax under section 294 (d) (2) are not to be applied when no declaration of estimated tax has been filed. Respondent's determination of additions to tax under section 294 (d) (2) for 1952 are accordingly disallowed. For 1953 petitioner did file a declaration of estimated tax, although not until January 14, 1954. Respondent determined that this declaration was untimely and petitioner has offered nothing to indicate the contrary. Nor has petitioner shown that his failure to file a timely declaration was due to reasonable cause and not to willful neglect. The addition to tax determined for 1953 under section 294 (d) (1) (A) is therefore upheld. A declaration having been filed for 1953, Commissioner v. Acker, supra, has no application to the addition to tax determined under section 294 (d) (2) for that year, and this determination is also upheld. Rose S. Harkins, 33 T.C. . . . (Nov. 30, 1959). Section 294 (d) (1) (B) imposes an addition to tax for failure to pay installments of estimated tax when either a timely declaration was filed or a declaration was late due to reasonable cause and not to willful neglect. Respondent may not impose additions to tax under both section 294 (d) (1) (A) and section 294 (d) (1) (B). Regs. 118, sec. 39.294-1 (b) (2). The addition to tax determined for 1953 under section 294 (d) (1) (B) is accordingly disallowed.

Decision will be entered under Rule 50.

DECISION

(Title Omitted)

Respondent having on May 4, 1960 filed a recomputation of tax for entry of decision in accordance with Memorandum Findings of Fact and Opinion herein, filed February 29, 1960, and this proceeding having been called from the Washington, D. C. calendar on June 8, 1960, and petitioners not having appeared in opposition to respondent's computation, now, therefore, it is

Ordered and Decided: That there are deficiencies in income tax and additions to tax as follows:

		Additions to tax—I.R.C. 1939		
Year	Deficiency	Sec. 294 (d) (1) (A)	Sec. 294 (d) (1) (B)	Sec. 294(d) (2)
1952	$ 297.04	$2,664.07		None
1953	15,459.18	1,164.06	None	None

CLARENCE V. OPPER,
Judge.

Enter:
Entered Jun. 13, 1960.
Served Jun. 14, 1960.

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 18963

A. J. WHIPPLE and MILDRED WHIPPLE,
Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE
Respondent.

Petition for Review of Decision of the Tax Court of the United States

(April 4, 1962)

Before TUTTLE, Chief Judge, HUTCHESON and RIVES, Circuit Judges.

TUTTLE, Chief Judge: The taxpayer-petitioners here complain of the decision of the Tax Court which held that the taxpayers' advances to the corporation, in which the husband held a majority interest, represented, within the meaning of Section 23 (k) of the 1939 Internal Revenue Code, a non-business rather than a business bad debt, when these advances became worthless upon the insolvency of the corporation. So far as is significant here a non-business

bad debt is defined in the statute as one "other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business." The debt which the petitioner claims he should be allowed to deduct as a business bad debt represents the balance of unpaid advances which Whipple had made to Mission Orange Bottling Company, a soft drink bottling company, in which he owned approximately 80% of the stock and of which, at the time of the debt becoming worthless, he had assumed the active management because of its unsuccessful operation thus far. The final advance of $48,000 was made by taxpayer to Mission Orange coincidentally with its transfer to him of its entire physical assets on December 15, 1953. This left his unrecovered claim against Mission Orange at $56,975.10. It is conceded that this amount became worthless during the month of December, 1953.

The Tax Court, based on ample evidence, found that during the period of four years commencing in 1949, petitioner was instrumental in incorporating fifteen corporations, fourteen of these were engaged in construction, building or real estate business; petitioner owned an interest in five additional construction or real estate corporations, and at one time or another was a member of ten partnerships involved in similar activities; during this period of time the petitioner spent the major part of his time and energies in the construction or real estate business, or the related building supply business; on April 25, 1951, petitioner obtained a franchise from the Mission Dry Corporation entitling him to produce, bottle, distribute and sell Mission Beverages in certain counties in Texas; during the same month he purchased the bottling machinery and equipment then owned by one D. C. Casey, who was operating the Mission Orange

Company in Lubbock, Texas; he conducted this business as a sole proprietorship until approximately July 1, 1951, at which time he organized debtor corporation, Mission Orange Bottling Company, and transferred the bottling machinery and equipment to it; the bottling business was apparently not successful, for during the years 1952 and 1953, he made advances to it so that including the amount which the corporation owed him as the result of his sale of the bottling assets, it was indebted to him in the sum of $79,489.06, on December 1, 1953. On December 15th petitioner advanced Mission Orange $48,000 to pay general creditors, and on the same date he received a transfer from Mission Orange of bottling machinery, equipment and an automobile, which had the value of $70,414.66. This left a net amount due by Mission Orange to him of $56,975.10, which the Tax Court found became worthless during the month of December, 1953.

The Tax Court, in its opinion, stated:

> "If we were required to find a definite time of worthlessness we should be inclined to say December 15, 1953, at which time petitioner received the bottling machinery from Mission Orange in partial satisfaction of that corporation's obligation."

Thus it appears that at the time when the sum of $48,000 of the indebtedness in issue was advanced to Mission Orange petitioner had no hope of its being recovered.

Petitioner recognizes the usual rule that where the controlling stockholder of a corporation is unable to obtain repayment of moneys he advances to his corporation to bolster up its operating possibilities this is generally con-

sidered a non-business bad debt. This follows because in such a case the loan or advance made by the taxpayer to the corporation is no part of any business which he is engaged in individually. It is an advance or loan made by him to enable his wholly owned corporation to make a profit. The petitioner here, however, contends that his extensive activity in the formation of the numerous corporations and the extensive activity he himself performed in attempting to save the Mission Orange Company in its operation, made these particular advances loans in some separate trade or business carried on by the taxpayer.

The Tax Court made the following findings of fact:

> "Petitioner was not in the business of organizing, promoting, managing or financing corporations in 1953. He was not in the business of lending money in that year."

In its opinion the Tax Court also determined that taxpayer was not personally in the business of bottling and selling soft drinks at the time he made the advances that resulted in the debt here in issue.

In the case of *Giblin v. Commissioner*, 5 Cir., 227 F. 2d 692, this Court said:

> "We recognize the fact that the question whether the activities of a taxpayer constitute carrying on a trade or business is largely one of fact, the solution of which 'requires an examination of the facts in each case.' Higgins v. Commissioner of Internal Revenue, 312 U.S. 212, 217, 61 S. Ct. 475, 478, 85 L. Ed. 783. The findings of the Tax Court or the District Court, therefore, are normally critical on this issue."

The Giblin case is one in which this Court found that under the peculiar circumstances which were there present a taxpayer could treat a loss, resulting from the failure of his wholly or partially owned corporations to repay advances, as a business bad debt. In articulating the circumstances which justified a finding of the existence of a business bad debt, we said:

> "Taxpayer did not seek to show that he was engaged in the business of making loans. Neither did he seek to have the Tax Court 'pierce the corporate veil' and find that he was engaged in the restaurant business or in any of the other businesses which he had promoted and dealt with during the preceding twenty years. What he did seek to prove was that he was regularly engaged in the business of seeking out business opportunities, promoting, organizing and financing them, contributing to them substantially 50% of his time and energy and then disposing of them either at a profit or loss . . ."

We further stated:

> "Petitioner's right to deduct the amount of the cancelled debt depends not upon his showing, as the Tax Court seemed to think, that he was in the business of lending money, but rather that he was regularly engaged in the business of 'dealing in enterprises,' during the course of which he operated either as a proprietor, as a stockholder, as a partner or a lender or in a combination of these capacities, contributing to each enterprise his own initiative and energy, and such financial backing as it required."

We think that the Tax Court was amply warranted in finding that there was no evidence in this record, other than the simple fact that taxpayer had used his talents as a building contractor to organize a large number of companies to conduct such building operations, that he was interested in any way in doing any more than enabling these separate corporation to achieve a successful and lucrative operation as corporations. Taxpayer's claim, it seems clear to us, falls within the class of those who fail to recognize the distinction between carrying on one's business through a corporate form, which of course, requires some organizing and financing, and the business of dealing in corporations, which may likewise require some financing arrangements. As stated by the Court of Appeals for the Ninth Circuit in *Holz v. Commissioner of Internal Revenue,* 256 F. 2d 865, at page 870:

> "Where the former is the situation, it is horn book law, and not contested by petitioner, that the corporate entity is the primary debtor and stockholder loans to protect his investment or increase its value do not create a separate business for the stockholders. As the Fifth Circuit recently said in distinguishing the Giblin case, supra, 'Petitioner was not engaged in the business of dealing in enterprises.' Pokress v. C.I.R., 1956, 234 F. 2d 146, 150 note 12 Nor did the Tax Court, nor do we, find him so engaged here. The finding of the Tax Court is binding upon us unless clearly erroneous. Here, it is not."

This opinion then cited the case of *Burnet v. Clark,* 287 U.S. 410, where at page 415 the Supreme Court said:

> "[The taxpayer] was not regularly engaged in indorsing notes, or buying and selling corporate securities. The unfortunate indorsements were not part of his ordinary business, but occasional transactions intended to preserve the value of his investment in capital shares."

The case of *Ferguson v. Commission*, 4 Cir., 253 F. 2d 403, is equally persuasive of the correctness of the Tax Court's decision here. In that case it was said, "It is now well settled that debts such as these are not deductible as business bad debts unless the taxpayer is so extensively engaged in the business of promoting or financing business ventures as to elevate that activity to the status of a separate business." 253 F. 2d 403, 406.

So far as relates to the petitioner's contention that he was engaged in the separate business of lending money, we think that the Tax Court's finding that the relatively small number of interest bearing loans made by the taxpayer did not constitute a separate business engaged in by him. Further more, we think it was certainly within the ability of the Tax Court to find as a fact that the particular advances made to the Mission Orange Company, especially the $48,000 advanced on the date on which it stripped itself of all of its physical assets, were not made in the course of a separate business conducted by the taxpayer. We certainly cannot find that this determination by the Tax Court was clearly erroneous.

The decision of the Tax Court is

AFFIRMED.

HUTCHESON, Circuit Judge, Dissenting:

The sole question for decision in this case is whether the $56,975.10 debt of Mission Orange Bottling Company of Lubbock, Inc. to petitioner, A. J. Whipple, was a business bad debt or a non-business bad debt within the meaning of Sec. 23 (k) (1) or Section 23 (k) (4), respectively, Internal Revenue Code of 1939. I am unable to agree with the opinion of the majority, and, for the reasons hereinafter stated, I dissent.

It was stipulated: (1) that it was a debt; and (2) that it became worthless in 1953.

The answer to the question turns on whether or not the loss resulting from the debt's becoming worthless did or did not bear a proximate relationship to the conduct of a business in which petitioner Whipple was engaged at the time the debt became worthless.

The taxpayer is here insisting that the tax court below and the government in its brief and on oral argument have failed to recognize and give effect to the fact that, though taxpayer's activities which gave the debt rise might not lend themselves to a specific name or label, they were certainly of a business nature within the meaning and intent of the act, in that the petitioner engaged in them for the purpose of deriving income therefrom, and the bad debt loss suffered had a direct relationship to the conduct of these business activities.

I agree with these views. While the act is loosely drawn and has the fault of a negative approach to definition, that is, seems to be more concerned with stating what is not, than with what is, a business debt, we think that

the language of the statute and regulation involved and its legislative history shows that the intent was not to

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[1] **Internal Revenue Code of 1939:**

"Sec. 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

* * * * *

[As amended by Sec. 1315 (a) Rev. Act of 1942, c. 619, 56 Stat. 798] (k) Bad Debts.—

"(1) General rule.—Debts which become worthless within the taxable year; * * *. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection. * * *"

* * * * *

"(4) Non-business debts.—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt, the worthlessness of which is incurred in the taxpayer's trade or business."

* * * *

(26 U. S. C. 1952 ed. Sec. 23)

"Treasury Regulations 118 (1939 Code):

"Sec. 39.23 (k)—6. Non-business bad debts. (a) * * *

"(b) The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a non-business debt for the purposes of this section."

[2] As the House of Representatives Report No. 2333, 77th Congress, First Session, states in regard to the Revenue Act of 1942, at page 409 of Cumulative Bulletin 1942-2:

"The present law gives the same tax treatment to bad debts incurred in non-business transactions as it allows to business bad debts. An example of **a non-busicss bad debt would be an**

deny a business bad debt deduction under the facts presented in this case.

I think, too, that the tax court, the Commissioner, and the majority opinion of this court have erred when, instead of relying on the language and legislative history of the act, they have placed their reliance on the gloss which has been put on the statute by various and sundry decisions cited by them which have construed this remedial statute so narrowly as practically to defeat its remedial purpose.

The language of the act and its legislative history both show that congress, desiring to encourage risk taking with respect to loans incurred in connection with business and to discourage the making of loans for use taxwise to kinsmen or friends, gave favorable tax treatment to bad debts arising out of, or in connection with business ventures, while denying such treatment to purely personal bad debts or those where other than business considerations moti-

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unrepaid loan to a friend or relative, while business bad debts arise in the course of the taxpayer's trade or business. This liberal allowance for non-business bad debts has suffered considerable abuse through taxpayers making loans which they do not expect to be repaid. This practice is particularly prevalent in the case of loans to persons with respect to whom the taxpayer is not entitled to a credit for dependents. The situation has presented serious administrative difficulties because of the requirement of proof." (emphasis added).

The Senate Committee Reports contain no further explanation of the purpose for the insertion of the subsection which became 23 (k) (4).

The relationship which the loan must have to a taxpayer's business was explained in the House Committee Report on page 31 of C.B. 1942-2 where it quoted from Treasury Regulation 118, as shown in note 1, above, and then went on to give illustrations of debts which were incurred in what was obviously a business transaction to show how the time of the debt's becoming worthless would control in determining its proximate relationship to the taxpayer's business.

vated the lending. I think that the purpose of the statute was, and is, not advanced and the remedy is completely defeated when the mischief the statute was designated to meet is dropped entirely out of consideration, as in the board's decision here, in some of the decisions the board relies on, and in the majority opinion.

In the beginning of the interpretation of the statute and its application, the decisions were not so at fault. In the very first year of the applicability of Sec. 23 (k) (4), 1943, the question of how proximate the relationship of the debt to a business of the taxpayer must be was raised and decided in the case of Robert Cluett, 3rd, et ux v. Commissioner, 8 T. C. 1178 (1947). In that case the taxpayer sold a one-fourth ownership in a stock exchange seat for $125,000 and took a note from the purchaser for $65,000. The purchaser subsequently went bankrupt, leaving $28,985.97 owing on the note. The taxpayer deducted this sum as a business bad debt and the court allowed it as such.[3]

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[3]In allowing this as a business bad debt, the court said:

"The principal contention of the respondent seems to be that the loss from the bad debt in question did not arise in the ordinary course of the operation of a business involving the buying and selling of stock exchange seats. The petitioner does not contend that he was regularly engaged in any such business. Neither does he contend that the loss in question was one sustained in a usual transaction of any partnership of which he was a member. He contends, however, that the loss resulted directly from the operation of the business in which he was regularly engaged, both at the time the sale was made and at the time the debt became worthless, and, in the alternative, that the loss was at least proximately related to or connected with the business. * * *"

"The legislative history of Sec. 23 (k) (4) indicated that its principal purpose was to place a limitation upon losses from bad debts, such as loans to relatives or friends which had no connection with the business of the lender. * * * (Emphasis supplied)

(Cont'd.)

It is significant to note that the Treasury Department acquiesced in this interpretation of the statute, 1947-2 CB (2).

The next case to pass on the meaning of Sec. 23 (k) (4) was that of *Campbell v. Commissioner*, 11 T. C. 510 (1948), involving the taxable year 1944. The three petitioners in the Campbell case had been engaged since 1929 in organizing, owning and operating corporations (in total 12) engaged in the retail coal business. It was their practice as a part of their business to advance to (or leave with) those corporations on open account money belonging to them in many different instances. One of those corporations was the Campbell Bros. Coal Co. of Akron. The loans to that company which were in question were similar to loans made to others of their companies. The court, in determining that the loss resulting from such worthlessness was a business bad debt, denied the government's claim that taxpayer's loss fell under Section 23 (k) (4).[4]

"The debt here in question was not the result of a loan by the petitioner to a friend or relative or an isolated transaction which bore no relation whatsoever to the business in which he was engaged, but, on the contrary, was closely related to the business of owning and using a stock exchange membership for the production of income, in which business the petitioner was engaged not only in 1929, when the debt was created, but also in 1943, when it became worthless. * * *"

[4]The court said: "* * * They were debts, the loss from the worthlessness of which was incurred in the taxpayer's business. A finding has been made that they were business rather than nonbusiness bad debts, because the evidence shows that they had a direct connection with the business carried on by these petitioners, and the losses were directly the result of, and incurred in, the business of **organizing and operating corporations engaged in the retail coal business, which business of**

The commissioner also acquiesced in this case, decided in 1948, 1949-1 CB (1).

The Treasury's acquiescence in the Cluett and Campbell cases has never been withdrawn, and they still stand as the basic interpretative decisions on the statute.

The taxpayer in the Cluett case was certainly not in the business of selling stock exchange seats, and Mr. Campbell was not in the business of selling coal companies. Yet the government contends, and the tax court and the majority have erroneously held, that in order for the loss to be deductible, taxpayer Whipple must show that the numerous corporate enterprises which he promoted, financed, and managed were formed by him for sale. This extension of the restriction on the qualification of business bad debts contended for by commissioner and tax court considerably restricts the remedy which congress provided for curing the mischief it had in mind. I think it clear that such restriction was never contemplated by Congress. Indeed the contention pressed here emasculates a clearly intended remedial law.

Looking at the question in the light of the language of the act and its legislative history, I am in no doubt that the tax court was wrong in citing and relying on cases to the contrary of these views for such a restrictive and defeating construction.

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organizing and operating such corporations was carried on by the petitioners during the taxable year. These are not cases in which losses of corporations are being confused with losses of individuals or in which the business of a corporation is being confused with the business of individuals. Nor are they like net loss carry-over cases in which the loss occurred in isolated transactions rather than in the operation of a business. * * *" (Emphasis added)

I am also of the opinion that the great weight and number of decided cases[5] and the strength of their reasoning support petitioner's view. The case of *Giblin v. Commissioner*, note 5, supra, decided by this court, carefully and correctly construed and applied the statute and gave it a construction and application which the petitioner contends for and is entitled to here.

It seems to me that the basic fault of the majority opinion is in holding, as it in effect does, that business bad debt treatment must be denied the taxpayer here because the loan was to a corporation in which he was interested. This holding is, in my opinion, a clear addition to the taxing statute. If congress had so intended, it could and would have so provided. Not having done so, neither the tax court nor this court can construe the statute as though it contained such provision.

EDWARD W. WADSWORTH
Edward W. Wadsworth
Clerk, U. S. Court of Appeals,
Fifth Circuit
New Orleans, Louisiana

May 28, 1962

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[5]Giblin v. Commissioner, 227 F (2) 692; Maytag v. U. S., 289 F (2) 647; Trent v. Commissioner, 291 F (2) 669; Maloney v. Spencer, 172 F (2) 638; Sage v. Commissioner, 15 T.C. 299; Foss v. Commissioner, 75 F (2) 226; Commissioner v. Stokes Estate, 200 F (2) 637; Scott v. Commissioner, 14 TCM 1029.

JUDGMENT.

Extract from the Minutes of April 4, 1962.

A. J. WHIPPLE and MILDRED WHIPPLE

No. 18963 versus

COMMISSIONER OF INTERNAL REVENUE

This cause came on to be heard on the petition of A. J. Whipple and Mildred Whipple for review of a decision of the Tax Court of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the decision of the Tax Court in this cause be, and the same is hereby, affirmed.

"Hutcheson, Circuit Judge, Dissenting."

* * *

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 18, 963

A. J. WHIPPLE and MILDRED WHIPPLE,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

Petition for Review of Decision of the Tax Court of the United States.

(May 11, 1962)

ON PETITION FOR REHEARING

Before TUTTLE, Chief Judge, HUTCHESON and RIVES, Circuit Judges.

PER CURIAM:

It is ORDERED that the petition for rehearing filed in the above styled and numbered cause be, and the same is, hereby DENIED.

HUTCHESON, Circuit Judge: "I dissent"

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 18, 963

A. J. WHIPPLE and MILDRED WHIPPLE,
Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE
Respondent.

ON CONSIDERATION OF THE APPLICATION of the petitioners in the above numbered and entitled cause for a stay of the mandate of this Court therein, to enable petitioners to apply for and to obtain a writ of certiorari from the Supeme Court of the United States, IT IS ORDERED that the issue of the mandate of this Court in said cause be and the same is stayed for a period of 90 days from May 11, 1962; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within 90 days from May 11, 1962 there shall be filed with the Clerk of this Court the certificate of the Clerk of the Supreme Court that certiorari petition and record have been filed. It is further ordered that the Clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of 90 days from May 11, 1962, unless the above-mentioned certificate shall be filed with the Clerk of this Court within that time.

/s/ ELBERT P. TUTTLE
Chief Judge

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FILED

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 305

A. J. WHIPPLE & MILDRED WHIPPLE, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE COMMISSIONER

Under the Internal Revenue Code of 1939 bad-debt losses are fully deductible only if they are incurred in a trade or business of the taxpayer.[1] This case presents the question whether the activity of the taxpayer, A. J. Whipple, in organizing, financing, and managing the Mission Orange Bottling Co., a corporation of

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[1] Otherwise such losses are deductible within the limits prescribed for short term capital losses. Internal Revenue Code of 1939, Secs. 23(k)(1), (4), 117(d)(2). Similar rules are established by the Internal Revenue Code of 1954, Secs. 166(a), (d), 1211.

which he owned 80% of the stock constituted—either by itself or in conjunction with the taxpayer's similar activities in connection with a number of other corporations engaged in distinct enterprises—a "business" so that losses from the non-repayment of loans to the bottling corporation were fully deductible as "business" bad debts.

Having found that the taxpayer hoped to profit from the business activities of the corporations in which he owned stock and not from his own activities as promoter of these corporations or dealer in their stock, both the Tax Court and the Court of Appeals for the Fifth Circuit sustained the Commissioner's disallowance of the claimed deduction. Their decisions thus hold that, for the purposes of a taxpayer's claim of a deduction for a business bad debt, the business of a corporation is not the individual business of any of its shareholders, not even of a shareholder who actively engages as an individual in running the affairs of the corporate entity. They also hold that a taxpayer whose hope of profit springs from operations being carried on by a corporation—or several of them—of which he is a shareholder, is not in the "business" of organizing, financing, and managing corporations.

We believe that the decision below is correct. It is consistent with decisions of the Courts of Appeals for the Second[2] and Ninth[3] Circuits. It appears, however, to be in direct conflict with a recent decision of the Court of Claims[4] and to conflict, at least in principle, with the decisions of several courts of appeals.[5] Since

[2] *Wheeler* v. *Commissioner*, 241 F. 2d 883.

[3] *Holtz* v. *Commissioner*, 256 F. 2d 865.

[4] *Maytag* v. *United States*, 289 F. 2d 647.

the question on which these courts are in conflict is one of continuing importance, and since this case is an appropriate one for its resolution, we do not oppose the issuance of a writ of certiorari.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

SEPTEMBER, 1962.

[5] *E.g.*, *Mays* v. *Commissioner*, 272 F. 2d 788 (C.A. 6); see also, *Washburn* v. *Commissioner*, 51 F. 2d 949 (C.A. 8); *Foss* v. *Commissioner*, 75 F. 2d 326 (C.A. 1); *Commissioner* v. *Stokes' Estate*, 200 F. 2d 637 (C.A. 3).

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NO. 305

IN THE

Supreme Court of the United States

OCTOBER TERM 1962

A. J. WHIPPLE AND MILDRED WHIPPLE,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR PETITIONER

CHARLES DILLINGHAM
BEN H. SCHLEIDER, JR.
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SUBJECT INDEX

	PAGE
OPINIONS BELOW	1
JURISDICTION	1
STATUTES INVOLVED	2
QUESTION PRESENTED	3
STATEMENT OF THE CASE	3
POINTS FOR REVIEW	14-15
SUMMARY OF ARGUMENT	15
Summary of First Point	15
Summary of Second Point	17
Summary of Third Point	20
Summary of Fourth Point	20
FIRST POINT (RESTATED)	23
A. Interpretation Clear 1942-1954	24
B. Enactment of Internal Revenue Code of 1954 Confirmed Prior Decisions	36
SECOND POINT (RESTATED)	41
THIRD POINT (RESTATED)	54
FOURTH POINT (RESTATED)	60
CONCLUSION	77
PROOF OF SERVICE	78

LIST OF AUTHORITIES

CASES	PAGE
Alexander v. Commissioner, 34 TC 758	18, 40, 42, 43
Averill v. Commissioner, 20 BTA 1196	30, 43
Bingham's Trust v. Commissioner, 325 U.S. 365, 89 L.Ed. 1670	64
Campbell v. Commissioner, 11 TC 510	16, 17, 18, 27, 28, 30, 36, 37, 39, 40, 41, 43, 44, 50, 66, 69, 75
Cluett v. Commissioner, 8 TC 1178	26, 27, 28
Commissioner v. Bedford, 325 U.S. 283, 89 L.Ed. 1611	64
Commissioner v. LoBue, 351 U.S. 243, 100 L.Ed. 1142	64
Commissioner v. Stokes' Estate, (3 Cir.) 200 F.2d 637, 53-1 USTC para. 9164	14, 16, 18, 34, 35, 36, 40, 42, 43, 59, 66
Commissioner v. Smith, (2 Cir.) 203 F.2d 310, 53-1 USTC para. 9317	31, 65
Dobson v. Commissioner, 320 U.S. 489, 88 L.Ed 389	64
Flint v. Stone Tracy Co., 220 U.S. 107, 55 L.Ed 389	31
Foss v. Commissioner, (1 Cir.) 75 F.2d 326, 35-1 USTC para. 9091	14, 16, 17, 18, 29, 30, 35, 36, 40, 42, 43, 66, 67, 68
Giblin v. Commissioner, (5 Cir.) 227 F.2d 693, 56-1 USTC para. 9103	17, 37, 40, 42, 43, 45, 46, 47, 48, 49, 59
Higgins v. Commissioner, 312 U.S. 212, 85 L.Ed. 783	59, 72
Holtz v. Commissioner, (9 Cir.) 256 F.2d 865, 58-2 USTC para. 9620	17, 42, 43, 44, 45, 47, 49
Lutz v. Commissioner, (5 Cir.) 282 F.2d 614, 60-2 USTC para. 9687	74
Maloney v. Spencer, (9 Cir.) 172 F.2d 638, 49-1 USTC para. 9176	14, 16, 17, 18, 19, 32, 36, 37, 39, 40, 41, 42 50, 55, 56, 59, 60, 66, 72
Macy v. Commissioner, 8 TCM 45	16, 28, 29, 30, 35, 36, 40, 43, 69, 75
Mays v. Commissioner, (6 Cir.) 272 F.2d 788, 60-1 USTC para. 9122	13, 17, 18, 38, 41, 43, 50, 59, 65, 68, 69
Maytag v. U. S., (U. S. Court of Claims) 289 F.2d 647, 61-1 USTC para. 9424	14, 17, 18, 39, 42, 69
Pokress v. Commissioner, (5 Cir.) 234 F.2d 146, 56-2 USTC para. 9610	45, 49
Putnam v. Commissioner, 352 U.S. 82, 1 L.Ed.2d 144	37
Rollins v. Commissioner, (4 Cir.) 276 F.2d 368, 60-1 USTC para. 9357	46
Rollins v. Commissioner, 32 TC 604	46
Sage v. Commissioner 15 TC 299	16, 18, 33, 34, 35, 36, 37, 40, 42 ,50, 63, 66
Scott v. Commissioner, 14 TCM 1029, TCMemo 1955-258	17, 18, 37, 40, 42, 43, 50, 59, 71

CASES	PAGE
Trent v. Commissioner, (2 Cir.) 291 F.2d 669, 61-2 USTC para. 9506	17, 18, 42, 59
Vreeland v. Commissioner, 31 TC 78	46
Washburn v. Commissioner, (8 Cir.) 51 F.2d 949, 2 USTC para. 791	14, 18, 30, 42, 49, 65, 66, 75

STATUTES AND TEXTS	
1942-2 Cumulative Bulletin 409	24
1942-2 Cumulative Bulletin 572	24, 25
1942-2 Cumulative Bulletin 431	25
1947-2 Cumulative Bulletin 2	26, 27
1949-1 Cumulative Bulletin 1	16, 28
1951-1 Cumulative Bulletin 3	34
26 USCA, Sec. 23(k)(1) IRC 1939	2, 3, 17, 29, 35, 36, 66
26 USCA, Sec. 23(k)(4) IRC 1939	2, 3, 13, 15, 16, 17, 19, 24, 26, 27, 28, 30, 31, 34, 36, 37, 38, 41, 61, 66, 77
26 USCA, Sec. 23(e) IRC 1939	15, 25, 30, 31
26 USCA, Sec. 23(a) IRC 1939	29
26 USCA, Sec. 166(a) IRC 1954	17, 36
26 USCA, Sec. 166(d) IRC 1954	17, 36
26 USCA, Sec. 114(a) IRC 1939	2
26 USCA, Sec. 7482(a) IRC 1954	2
28 USCA, Sec. 1254(1)	2
5 Am. Jur. 2nd p. 268	64
5 Am. Jur. 2nd p. 272	64
63 CCH Tax Service para. 1627.461	38
Art. 5070, Vernon's Annotated Statutes of the State of Texas	71
Treasury Regulation 39.23(k)-6(b)	3

NO. 305

IN THE

Supreme Court of the United States

OCTOBER TERM 1962

A. J. WHIPPLE AND MILDRED WHIPPLE,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the Tax Court (R. 24) is reported as a memorandum decision in 19 TCM 187, TC Memo 1960-36. The opinion of the Court of Appeals for the Fifth Circuit (R. 133) is reported at 301 F. 2d 108, 62-1 USTC para. 9385.

JURISDICTION

The judgment of the Court of Appeals was entered on April 4, 1962 (R. 144). Rehearing was denied on May 11,

1962 (R. 148). Petition for a writ of certiorari was filed August 7, 1962 and was granted October 22, 1962. The jurisdiction of this Court rests on 26 USCA, Sec. 1141(a) Internal Revenue Code of 1939 (26 USCA, Sec. 7482(a) Internal Revenue Code of 1954) and 28 USCA, Sec. 1254(1).

STATUTES INVOLVED

The statutes in question are Section 23(k)(1) and Section 23 (k)(4) of the Internal Revenue Code of 1939, 26 USCA, IRC 1939, Section 23(k) p. 46.

Section 23 (k)(1) of Internal Revenue Code, 1939 (k) Bad Debts

> (1) General Rule—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. This Paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection . . .

Section 23(k)(4) of the Internal Revenue Code of 1939

> (4) Non-Business Debts—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset

held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

QUESTION PRESENTED

The sole issue in this case is whether the $56,975.10 debt of Mission Orange Bottling Co. of Lubbock, Inc., to Petitioner, A. J. Whipple, was a business bad debt or a non-business bad debt within the meaning of Section 23(k)(1) or Section 23(k)(4), respectively, Internal Revenue Code of 1939. It was stipulated (1) that it was a debt; and (2) that it became worthless in 1953. (R. 56).

This turns on whether or not the loss resulting from the debt's becoming worthless bore a proximate relationship to the conduct of a business in which Petitioner, A. J. Whipple, was engaged at the time it became worthless. T. R. 39:23(k)-6(b).

STATEMENT OF THE CASE

A. J. Whipple and Mildred Whipple are husband and wife and reside in Houston, Texas. They filed their joint income tax returns for 1952 and 1953 with the District Director of Internal Revenue at Austin, Texas. Albert J. Whipple, as head of the marital community within the meaning of the community property laws of the State of Texas, will hereinafter be referred to as "Petitioner". (R. 41)

Petitioner started into business for himself in 1941 by going into a building partnership with W. E. Brown, which continued for about a year. (R. 84-85).

Petitioner then entered into a construction partnership with Miles Strickland and W. C. Perkins under the name of SWP Construction Company to build houses in Greens Bayou, Harris County, Texas (R. 85). About the same time Miles Strickland offered to let Petitioner build a shopping center and houses for 24 per cent of the stock in a corporation known as Industrial Homes (R. 86) which was to own them.

~~In 1943~~ Petitioner, with others, promoted the formation of a corporation called Harbor Homes, in which Petitioner acquired a 40 per cent interest. It finished 63 housing units in Meadwood Estates, which had been taken over by a bonding company in a bankruptcy. (R. 86).

Petitioner bought some land on Airline Road and started to build a materials yard to go into business with one John Anderson. Strickland later wanted to get in and was taken as a one-third owner in a corporation that they formed called "Airline Lumber and Supply, Inc." (R. 90-91).

Petitioner then formed 29th and Airline, which built the yard and rented it to Airline Lumber & Supply, Inc. (R. 93) He also helped organize the partnerships, S. & W. Construction Company, Evergreen Rice Company, Ltd., Gulf Coast Plumbing and Supply, and State Tile Distributors. (R. 93).

State Tile Distributors was a wholesale tile company, which Petitioner, with George Listi, promoted by taking a trip, first to Cincinnati, and then to Anderson, Indiana. This was right after the War, when tile was still on government allocation; and, at first, they had difficulty. Finally, by talking with the Sales Manager of National Tile Company (R. 88-89), over a few drinks and lunch Petitioner offered to

buy four carloads of tile for $50,000 and they made a trade; all before they even had a name for the company. (R. 89). Miles and Bentley Strickland were then taken in as the other partners. (R. 88). Later Shakertown Distributors was formed with a John W. Anderson to distribute shingles. (R. 90).

During the years 1949 and 1950, Petitioner was an original incorporator of 7 corporations, as follows: Federal Road Building Corporation; Richmond Plaza, Inc.; Strickland-Whipple Construction Company, Inc., a successor to the partnership S. & W. Construction Company; Airline Lumber and Supply Company, Inc., a successor to the partnership, Airline Lumber and Supply Company, Ltd.; Dorwayne Construction Corporation; 29th and Airline, Inc., a real estate rental corporation which owned and rented the property occupied by Airline Lumber and Supply Company, Inc., and Shakertown Distributors; and Federal Road Lumber Company, Inc. (R. 25).

Petitioner, through his efforts, also acquired an interest in three Federal Housing Administration 608 apartment rental projects, Commonwealth and California, Commonwealth and Missouri, and Riverside Apartments. (R. 97-98).

In 1951 Petitioner's interests in all the various corporations and partnerships in which he had an interest were bought out by his partner and fellow stockholder, Miles Strickland, at book value, (R. 93-94) and Petitioner formed new ones with the money. (R. 95-96).

Petitioner bought property on Bissonnet and formed Whipple Lumber Company. (R. 95). He bought a restaurant on Fannin Street in April and a bottling plant in Lubbock. (R. 95). Later Petitioner bought some land in Bellaire and in Pasadena. (R. 95).

Petitioner helped promote an oil venture in West Texas with a group of people, and went into oil lease deals in Washington and Lee Counties. (R. 65). He helped organize a club to help the business in his restaurant. (R. 104-105). He bought land for Foley's warehouse when they only had five days in which to do it before construction was to be commenced, for which he was paid a fee reported as ordinary income. (R. 109-110). He was frequently brought other deals to help promote and for which to raise money, (R. 69) such as a cinder block business in 1953, (R. 66). He went into a lumber yard promotion deal with Alex W. Head after that. (R. 66).

Stipulation 23 (R. 46) gives some idea of the variety of Petitioner's activities.[1]

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[1] On March 18, 1953, petitioners filed a joint individual income tax return, Form 1040, for the taxable year 1952. Photostat thereof is hereto attached, marked Exhibit 13-M, and made a part hereof, showing income from the following sources:
(fol. 61

Form No.	Company	Exhibit No.
W-2	Whipple Lumber Company	13-M1
W-2	Whipple Construction Company	13-M2
W-2	Whipple Equipment Co., Inc.	13-M3
W-2	Angleton Homes Corp.	13-M4
W-2	Dozier-Whipple Const. Corp.	13-M5
1099	Federated Department Stores, Inc.	13-M6
1099	Durham-Clark Building Supply Co.	13-M7
1099	Whipple Lumber Company	13-M8

Interest received from 14 corporation, partnerships, and corporations:
Restaurant
Partnership
Lee County Oil Lease
Rent House Houston
Rental Building in Lubbock

In 1951 Petitioner formed a partnership, A. J. Whipple Construction Company, with V. L. Yarborough, Leonard Olive and G. A. Durham, and later A. J. Whipple Construction Company No. 2 with D. M. Dozier, (R. 100). He also formed the following corporations: Dozier-Whipple Construction Company, Whipple Construction Company, Inc., Angleton Homes, Inc., Chevy Chase Development Corporation, and Angleton Building and Holding Company. (R. 26).

In 1951 Petitioner also undertook the financing of these corporations, as shown by the interest schedule of ordinary income on his 1951 income tax return (R. 29), which shows interest received from five corporations as well as three partnerships. (R. 29)

Petitioner consistently financed the various partnerships and corporations in which he did have an interest through loans either individually or through a partnership (R. 92, R. 98, R. 100, R. 121).

Petitioner continued in this business of financing corporations and lending money, as is shown by the schedule attached to his 1952 income tax return showing ordinary interest income received from 14 corporations, partnerships and individuals (R. 156); and the advances in 1953 of $25,000 to $30,000 to Angleton Building and Holding Co. (R. 121); and the $52,500.00 advanced to Mission Orange Bottling Co. of Lubbock, Inc. (R. 63, Exhibit 21; R. 183ff).

His income tax returns for the years 1951-53 reflect interest income of $1,680.15, $2,285.35, and $1,747.59 respectively (R. 29).

Petitioner had also continued in the rental business forming Whipple Equipment Corporation in 1951 to rent auto-

mobiles, trucks, construction and other equipment (R. 101). In addition he bought personally the property and buildings at 2436 Bissonnet which he leased to Whipple Lumber Company, Inc. (R. 102-103, R. 106). This served as the home office of all the other corporations and partnerships which Petitioner controlled (R. 103). He also owned a rent house in Houston. (R. 46, Exhibit 13-M; R. 176) Petitioner individually bought some land in Lubbock and built a plant on it which he leased to Mission Orange Bottling Company of Lubbock, Inc. (R. 28; R. 116). Petitioner reported ordinary income of $15,570.58 as net rentals for the taxable year ending December 31, 1952, (R. 111; R. 47; Exhibit 13-M, R. 154) and $12,225.19 for the taxable year ending December 31, 1953 (R. 47, R. 111; Exhibit 20-T.; R. 176).

Petitioners formation and operation of these enterprises, also generated ordinary income in the form of salaries of $29,400.00 paid him in 1952 and $33,450.00 paid in 1953 (R. 26).

Petitioner organized a separate corporation by putting in 76 per cent of the original capital to act under a separate franchise as a distributor of franchised soft drinks in the Amarillo area which were bottled in the Mission Orange plant in Lubbock (R. 112-114).

Petitioner also organized a soft drink vending machine business separate and apart from the Mason Root Beer or Mission Orange Bottling operations with Ideal, Indiana. (R. 114-115).

On April 17, 1951, D. C. Casey, the owner and operator of Mission Orange Bottling Co., entered into an agreement, whereby he granted to Petitioner an option to purchase Mission Orange Bottling Co. (R. 42).

One of the principal conditions of the Casey-Whipple purchase option was that Petitioner obtain an assignment or a new lease of the premises on which Mission Orange Bottling Co. was then conducting its business, which new lease was obtained. (R. 42-43). Another prime condition was that Petitioner obtain a franchise from Mission Dry Corporation, authorizing him to distribute Mission Orange beverages. After Petitioner had been investigated for his financial and business ability to operate and manage a bottling plant, on April 25, 1951, Mission Dry Corporation of California issued a franchise for the Lubbock area to Petitioner personally. (R. 43; R. 57).

On April 27, 1951, D. C. Casey transferred by bill of sale the machinery and equipment of Mission Orange Bottling Co., located at 2518 Avenue H in Lubbock, to petitioner substantially according to the terms of the purchase option. (R. 43).

Upon consummation of the purchase option Petitioner assumed operations of the bottling business as a sole proprietorship and filed an assumed name certificate as Mission Orange Bottling Co. (R. 43).

Petitioner continued to operate Mission Orange as a sole proprietorship from date of its acquisition until July 1, 1951, at which time a $20,000 corporation, Mission Orange Bottling Co. of Lubbock, Inc., which Petitioner had incorporated, acquired most of the assets from him. (R. 27). He did not transfer the franchise to Mission Orange Bottling Co. of Lubbock, Inc. (R. 27) but continued to hold it personally through 1953. (R. 57).

The charter of Mission Orange was amended on December 7, 1952, to increase the authorized capital stock to $40,000.

Thereafter, the issued and outstanding stock was held as follows: (R. 45)

Shareholder	*Shares*	*Per Cent*	*Par Value*
Petitioner	308	77.	$30,800
James A. Finley	10	2.5	1,000
Charles Dillingham	2	.5	200
Cecil Clark	20	5.	2,000
Dora B. Ellzey	10	2.5	1,000
D. M. Dozier	10	2.5	1,000
Jack Knostman	20	5.	2,000
James F. Webster	20	5.	2,000
Total	400	100.	$40,000

Sometime prior to the end of 1953, Petitioner increased his holding to 318 shares, which was 79.5 per cent of those outstanding and represented an investment of $31,800. (R. 62).

In 1952 Petitioner erected a bottling plant on land which he purchased in Lubbock, Texas. (R. 116). The land and building cost a total of $43,601.70. On July 14, 1952, Petitioner leased this plant to Mission Orange for a 10-year term, beginning August 1, 1952, with an option to renew. The prescribed rental was $500.00 per month for the first 3 years and $500.00 per month plus 1 per cent of gross sales thereafter. (R. 44, R. 28).

During the years 1951, 1952 and 1953 Petitioner made 35 or 40 trips to Lubbock, and Mr. Finley, the plant manager in Lubbock, made a number of trips to Houston to discuss how the business was being run. (R. 118). Throughout this time Petitioner made all the managerial decisions as to policies, prescribed the business practices that should be followed, (R. 57, R. 117-119) and kept close control.

There were frequent long distance conversations between Petitioner and Mr. Finley on the bottling operations. (R. 118). In 1952 Petitioner started requiring Finley to file detailed reports to him every 24 hours, so that Petitioner could keep a check on and control of the business and again in 1953 sent Finley detailed letters of instructions (R. 117-118).

Finally in August, 1953, Finley's employment was terminated and Petitioner acted thereafter, and was acting on December 15, as Plant Manager, having only a plant superintendent in Lubbock (R. 119).

From July 1, 1951, until December 31, 1953, Petitioner paid expenses for Mission Orange Bottling Co. of Lubbock, extended credit to, loaned money to, made advances to or Inc., in the total amount of $131,778.26, and was repaid $74,803.16, leaving a net indebtedness of $56,975.10 (R. 75). Some of these advances and repayments were made through partnerships in which Petitioner had an interest, but in each case Petitioner personally was either charged or credited with the item. (R. 75-76). Others were in the form of guarantees which he had to make for the corporations accounts and loans. (R. 121)

Virtually all of the $131,778.26 loaned or advanced by Petitioner to Mission Orange Bottling Co. of Lubbock, Inc., except $25,502.50 representing the indebtedness against the assets of the proprietorship transferred by Petitioner to the corporation, were for the purpose of paying operating expenses, (R. 75) the last of which was in the amount of $48,000 on December 15, 1953. (R. 102-103; Exhibit 21, R. 183ff).

On the same date Petitioner was repaid $75,803.16 by Mission Orange Bottling Co. of Lubbock, Inc.'s transferring all of the bottling equipment of the corporation which Petitioner took in satisfaction of $67,332.91 worth of indebtedness, and an automobile which Petitioner took in satisfaction of $3,081.75 of indebtedness. (R. 77-78) This left the Mission Orange Co. with virtually no tangible assets, and as stipulated (R. 28) the debt became worthless.

Petitioner's activities during 1953 were not restricted to Mission Orange Bottling Co. of Lubbock, Inc. He continued to operate Cousin's Restaurant (R. 111), but the operation resulted in a $3,960 loss during 1953 (R. 178). He was also building and selling houses in several locations (R. 26; R. 111) and renting real estate (R. 112). Besides these activities and his management of Whipple Lumber Company and Whipple Equipment Company, Inc. (R. 101), he was brought other deals to consider, such as the cinder block business. (R. 66). As shown by his tax return for 1953 (R. 174), he received salaries from six corporations, income from one partnership in the amount of $27,177, interest of $1,747 and rentals from three properties (R. 176). He also loaned Angleton Building and Holding Corporation, a corporation which he had organized and managed (R. 96), between $25,000 and $30,000 during that year. (R. 121).

Petitioner introduced evidence in the Tax Court on four different types of business activities carried on by taxpayer, A. J. Whipple, for the purpose of producing ordinary income. (R. 45-47). This evidence also showed that the $56,975.10 bad debt in question had resulted from loans having been made by Petitioner in the ordinary course of carrying on these business activities.

Petitioner urged before the Tax Court and the United States Court of Appeals for the Fifth Circuit (R. 39) that the bad debt loss had resulted from Petitioner, A. J. Whipple's business activities in

1. Organizing, financing and managing corporations, partnerships and joint-ventures; or
2. Financing corporations and lending money; or
3. Acquiring, owning, expanding, equipping and leasing bottling plants and other equipment; or
4. Conducting activities in connection with the bottling and sale of soft drinks; or
5. A combination of the above activities.

Both the Tax Court and the majority of the Court of Appeals for the Fifth Circuit held that Petitioner, A. J. Whipple's activities in connection with points 1, 2 and 4 above did not qualify him for business bad debt treatment but made no finding as to points 3 and 5.

In so holding the Tax Court and the majority of the Court of Appeals for the Fifth Circuit held that in order for a taxpayer to deduct as a business bad debt one of many loans made in the course of organizing, financing and operating numerous corporations, he must also prove that he formed the corporations for the purpose of selling them.

Petitioner filed a Petition for a Writ of Certiorari in this Court on the grounds that the holding of the majority of the Court of Appeals for the Fifth Circuit below was in direct conflict with the following cases on the proper interpretation of Section 23(k)(4) IRC 1939: *Mays v. Commissioner*, (6 Cir.), 272 F. 2d 788, 60-1 USTC para.

9122, *Maloney v. Spencer* (9 Cir.), 272 F. 2d 788; 49-1 USTC para. 9176. *Commissioner v. Stokes' Estate*, (3 Cir.) 200 F. 2d 637, 53-1 USTC para. 9164, *Maytag v. United States* (U. S. Court of Claims), 289 F. 2d 647, 61-1 USTC para. 9424. It would appear that it is, also, in conflict with the case of *Foss v. Commissioner* (1 Cir.), 75 F. 2d 326, 35-1 USTC para. 9091 and *Washburn v. Commissioner* (8 Cir.), 51 F. 2d 949, 2 USTC para. 794.

POINTS FOR REVIEW

First Point

Congressional history shows that the addition of Section 23(k)(4) by the Revenue Act of 1942 was not intended to deny a busines bad debt deduction in the fact situation of this case.

Second Point

The majority of the Court of Appeals for the Fifth Circuit erred in affirming the holding of the Tax Court that the taxpayer in order to deduct as a business bad debt one of many loans made in the course of his extensive activities in organizing, managing and financing numerous corporations, must also prove that he was a person who had formed the corporations for the purpose of selling them.

Third Point

The majority of the Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to find that Petitioner was in the business of acquiring, own-

ing, expanding, equipping, leasing and renting real estate out of the conduct of which business the $56,975.10 bad debt resulted.

Fourth Point

The Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to hold that the extensive activities of the taxpayer in organizing, managing, operating, financing, lending, equipping and renting to corporations, partnerships and joint ventures constituted a business to which the $56,-975.10 bad debt was proximately related.

SUMMARY OF ARGUMENT

Summary of First Point

Prior to 1942 all bad debt losses were fully deductible under Section 23(k). This was abused by individuals making personal loans, and the Committee Reports on the Revenue Act of 1942 state this to be the chief reason for the insertion of Section 23(k)(4) which provides that a non-business bad debt shall be given short term capital loss treatment.

The Treasury Regulations provide that whether the debt is to be treated as a business or non-business bad debt is determined on the basis of its proximate relationship to the taxpayer's business at the time it becomes worthless.

It has been held that the Committee Reports made it clear that the meaning of "business" within Section 23(k) was the same as that used in Section 23(e)(1) as distinguished from "transactions entered into for profit" within Section 23(e)(2).

The basic rule that was adopted[1] and universally followed[2] by the courts from the enactment of Section 23(k)(4) in 1942 up to and through the enactment of the Revenue Code of 1954 was stated in the *Foss* case[3] as follows:

> "the line comes between those who take the position of *passive investors* doing only what is necessary from an investment point of view and those who associate themselves actively in the enterprises in which they are financially interested and devote a substantial part of their time to that work as a matter of business." (Emphasis supplied).

Under this "more than a passive investor" test it was held in the *Campbell* case[4], acquiesced in by the Treasury Department[5] and affirmed by later cases[6] that a taxpayer who organizes a number of corporations and actively participates in their management is considered to be in a business separate and distinct from that of the corporations and entitled to business bad debt treatment on loans to those corporations.

Similarly, one who acquires, manages, finances, equips and rents to corporations is considered to be in a business separate and distinct from that of the corporations and entitled

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[1] **Macy v. Commissioner,** 8 TCM 45

[2] **Macy v. Commissioner,** 8 TCM 45; **Sage v. Commissioner, 15** TC 299; **Maloney v. Spencer,** (9 Cir.) 172 F. 2d 638; 49 UST para. 9176; **Commissioner v. Stokes, (3 Cir.)** 200 F. 2d 637; 53-1 USTC para. 9164.

[3] **Foss v. Commissioner,** (1 Cir.) 75 F. 2d 326, 35-1 USTC para. 9091.

[4] **Campbell v. Commissioner,** 11 TC 510.

[5] 1949 - CB 1.

[6] **Macy, Sage, Stokes.** (supra Note 2).

to business bad debt treatment on loans to those corporations.[7]

The reenactment by Congress without substantially changing Sections 23(k)(1) and 23(k)(4) into Sections 166(a) and 166(d) should certainly be considered as a clear affirmation of the above stated rules.

The first case[8] decided after the enactment of the 1954 Code followed the *Foss* and *Campbell* rules, as have the great weight of authorities[9] since. Due to its reliance upon the misinterpretation by one court[10] of the loose language used in the dictum in another[11] case, the Tax Court below erred, and such error was affirmed by the Court of Appeals in imposing an additional requirement for qualification for business bad debt treatment, namely, that the corporations be organized for sale.

This was not intended by Congress and makes a radical departure from established law.

Summary of Second Point

The sudden addition of the requirement that corporations must be formed for sale was reversible error. The Tax Court

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[7] **Maloney v. Spencer,** (9 Cir.) 172 F. 2d 638; 49 USTC para. 9176.

[8] **Scott v. Commissioner,** 14 TCM 1029.

[9] **Mays v. Commissioner,** (6 Cir.) 272 F. 2d 788; 60-1 USTC para. 9122; **Maytag v. U.S.,** (U.S. Court of Claims) 289 F. 2d 647; 61-1 USTC para. 9424; **Trent v. Commissioner,** (2 Cir.) 291 F. 2d 669; 61-2 USTC para. 9506.

[10] **Holtz v. Commissioner,** (9 Cir.) 256 F. 2d 865; 58-2 USTC para. 9620.

[11] **Giblin v. Commissioner,** (5 Cir.) 227 F. 2d 692; 56-1 USTC para. 9103.

based its denial of the business bad debt deduction to Petitioner upon the fact that the record did not show that his purpose for organizing, financing and managing corporations was to develop them for sale to customers in the course of the business of promoting. This was the application of an incorrect legal standard and is reversible error.

The Tax Court cited as authority for this rule a Ninth Circuit case [12], which, in affirming the holding of the Tax Court as "not being clearly erroneous", had seized on certain loose language used in the dictum of a Fifth Circuit case[13] and misquoted the language of *Campbell v. Commissioner* (supra) to distinguish them.

This requirement, that corporations be formed for sale, is completely in conflict with a long line of cases,[14] including those of five of the seven Circuits passing on the question and the Court of Claims. The cases in using the "*more than a passive investor*" rule of the *Foss*[15] case allowed business bad debt deductions to taxpayers who organized a number of corporations and actively took part in their management. In none of these cases were the corporations organized for the purpose of sale.

[12] See Note 10.

[13] See Note 11.

[14] **Campbell v. Commissioner,** 11 T.C. 510; **Mays v. Commissioner** (6 Cir.), 272 F. 2d 788, 60-1 USTC para. 9122; **Maloney v. Spencer,** (9 Cir.) 172 F. 2d 638, 49-1 USTC para. 9176; **Commissioner v. Stokes' Estate,** (3 Cir.) 200 F. 2d 637, 53-1 USTC para. 9164; **Sage v. Commissioner,** 15 T.C. 299; **Scott v. Commissioner,** 14 T.C.M. 1029; **Alexander v. Commissioner,** 34 T.C. 758; **Trent v. Commissioner,** (2 Cir.) 291 F. 2d 669, 61-2 USTC para. 9506; **Maytag v. U. S.** (U. S. Court of Claims), 289 F. 2d 647, 61-1 USTC para 9424; **Foss v. Commissioner** (1 Cir.), 75 F. 2d 692, 35-1 USTC para 9091; and see also **Washburn v. Commissioner** (8 Cir.), 51 F. 2d 949, 2 USTC para. 794.

[15] **Foss v. Commissioner,** 75 F. 2d 326; 35 USTC para. 9091.

Thus this sudden addition of the requirement of the Tax Court, which was affirmed by the Court of Appeals below, is a radical departure from the established law as laid down by the cases and which, coming after the reenactment of Section 23 (k) (4), in substantially the same form, into the comprehensive Revenue Act of 1954, is clearly contrary to the intent of Congress.

The Tax Court's rationale for the adoption of such a rule, as indicated in its comments at the end of the trial, is that the word "business" connotes the generation of ordinary income, and that a promoter who organizes and sells corporations would be creating ordinary income.

There is no disagreement with the proposition that a promoter who sold corporations would create ordinary income and would be entitled to business bad debt treatment. However, it does not follow that this is the only way one who is engaged in organizing corporations can generate ordinary income. Another way, which the Tax Court actually mentioned in its comments but failed to take into consideration in its decision, is the creation of salary. As several of the cases have indicated, salaries are quite frequently paid for the over-all managerial functions made necessary by the complexities of organizing, managing and financing numerous corporations. Another is through interest paid for the financing of such corporations. A third is through rental income.

Petitioner, as is shown in detail under the Third and Fourth Points, carried on such extensive activities in connection with the organization active management, financing, renting to, and equipping of the numerous corporations formed as to generate substantial amounts of all three forms of ordinary income, as a result of which activities he suffered the bad debt loss in question.

Summary of Third Point

The courts' failure to find Petitioner was in the business of acquiring, owning, expanding, equipping, leasing and renting real estate was reversible error.

Although Petitioner introduced extensive evidence and urged in his brief to the Tax Court that he was engaged in the business of acquiring, owning, expanding, equipping and leasing bottling plants and other businesses, and introduced much evidence of the rental aspects of Petitioner's real estate business, the Tax Court failed to make any ruling on this point.

In addition to building the bottling plant and leasing it to Mission Orange Bottling Co. of Lubbock, Inc., as part of his over-all soft drink enterprise, Petitioner had a long history of acquiring property for rental purposes. In the years 1952 and 1953, in addition to the bottling plant, he was leasing a lumber yard site and a rent house which brought in net rentals of $15,570.58 in 1952 and $12,225.19 in 1953, plus operating a rental equipment corporation.

The facts show that Petitioner's loans to the debtor corporation were to a substantial degree induced by his renting to Mission Orange, and falls within the rule of *Maloney v. Spencer*[16] and should have been allowed a business bad debt deduction.

Summary of Fourth Point

If the Tax Court or the majority of the Court of Appeals for the Fifth Circuit had applied the correct legal standard to the facts of this case, Petitioner would have been allowed

[16] **Maloney v. Spencer,** (9 Cir.) 172 F. 2d 638; 49-1 USTC para. 9176

the $56,975.10 deduction as a business bad debt. The Tax Court and the Court of Appeals for the Fifth Circuit have applied too restrictive a legal standard in judging Petitioner's activities.

The Courts below held that for Petitioner's loss to be treated as a business bad debt he must show that he was either (1) in the separate business of buying and selling corporations; or (2) in the separate business of lending money; or (3) in the business of actually bottling drinks.

Petitioner engaged in a myriad of business activities, the cumulative effect of which clearly put them in the category of business activities as opposed to investment activities. The activities of the Petitioner in *organizing* and *managing* corporations, partnerships and joint ventures extended over a period of time from the commencement of his business career in 1941 to and including the year 1953 in which the loss was sustained.

The Tax Court's so-called findings of fact as to Petitioner's not being in a business as defined in Section 23(k) were really conclusions of law, based on incorrect legal standards, and hence are not binding on this Court. Had the proper rule of law been applied to the facts, as shown above, Petitioner would certainly qualify as having been in the business of regularly and continuously organizing and actively managing corporations.

The courts have recognized in the cases analyzed in detail in the First and Second Points that in order to organize, arrange for, and keep in touch with the financing of, coordinate the various activities of, and make the general policy decisions for a group of enterprises, as in Whipple's case, would necessarily take such extensive time, thought

and efforts of the taxpayer, separate and distinct from the business of each of the enterprises themselves, as to constitute a separate business distinct from that of the corporations themselves.

This is the basis for the distinction made by the cases between the activities of those who have organized and are managing and financing a number of corporations from those who merely invest or who manage and finance a single corporation.

Petitioner also engaged in extensive activities which go far beyond those of the ordinary organizer and manager of corporations. Petitioner consistently over a period of ten years financed the various partnerships, corporations and joint ventures in which he had an interest. The Courts took a narrow view in holding that because Petitioner's important business function of financing enterprises in connection with his activities of organizing and managing did not constitute a separate business of lending money, he was not entitled to take a business bad debt deduction.

Again, the Tax Court below took an overly restrictive view in considering only the bottling phase of his soft drinks enterprise, which was a part of his over-all business of organizing, financing, renting to, and managing corporations. The soft drinks enterprise, also included the ownership and renting of the building in which Mission Orange bottled the drinks, the organization of another corporation to distribute soft drinks, a soft drink vending machine business to further promote sales, and the personal ownership of the very franchise under which the Mission Orange drinks were bottled and sold.

Under the proper legal test laid down by the Courts, the bad debt in question was clearly the proximate result of the conduct of the soft drinks enterprise phase of Petitioner's business of organizing, financing, renting to, and managing corporations.

In addition to Petitioner's activities in organizing, managing and financing corporations, partnerships and joint ventures he supplied the plants and offices out of which all of these operated, and through this activity he generated substantial sums of ordinary income in the form of rents.

It is apparent from the record that Petitioner was regularly and continuously organizing, financing, renting to, and actively managing corporations. These activities were of the type which were reasonably calculated to, and in Petitioner, A. J. Whipple's case did, generate substantial amounts of ordinary income from sources separate and distinct from the conduct of the particular businesses of the corporations themselves, in the form of salaries, rents and interest. Had his soft drinks enterprise been a success, the income from all three of these sources would have undoubtedly been greater, and as a result of his efforts to make it so the $56,975.10 bad debt loss in question occurred. The error of the Courts in failing to so rule requires that this case be reversed and rendered.

First Point (Restated)

Congressional history shows that the addition of Section 23(k)(4) by the Revenue Act of 1942 was not intended to deny a busines bad debt deduction in the fact situation of this case.

A. Interpretation Clear 1942-1954

Prior to the Revenue Act of 1942, Section 124(a)[1], there was no distinction made in the Code between business and non business bad debts. The treatment accorded to bad debts was the same whether incurred in a trade or business or otherwise, and such bad debts were deductible in full. As the *House of Representatives Report No. 2333*, 77th Congress First Session, states in regard to the Revenue Act of 1942, at page 409 of Cumulative Bulletin 1942-2:

> "The present law gives the same tax treatment to bad debts incurred in non-business transactions as it allows to business bad debts. An example of a non-business bad debt would be an unrepaid loan to a friend or relative, while business bad debts arise in the course of the taxpayer's trade or business. This liberal allowance for non-business bad debts has suffered considerable abuse through taxpayers making loans which they do not expect to be repaid. This practice is particularly prevalent in the case of loans to persons with respect to whom the taxpayer is not entitled to a credit for dependents. The situation has presented serious administrative difficulties because of the requirement of proof."

The Senate Committee Reports contain no further explanation of the purpose for the insertion of the subsection which became 23(k)(4). At page 582 of 1942-2C.B., the Senate Report states about *Section 124 Deduction for Bad Debts, etc.*: "This Section is substantially the same as Section 119 of the House Bill." Then on page 574 the only difference is explained.[2]

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[1] 26 USCA, Sec. 23(k)(4) IRC 1939.

[2] "This section varies from the corresponding section of the House bill in that a loss resulting from the worthlessness of a non-business bad debt is to be considered a loss from the sale or

The Committee reports in both houses stated that the determination whether a debt is incurred in a trade or business "is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by Section 23(e) is incurred in trade or business under paragraph (1)[3] of that section." 1942-2 C.B., p. 573.

This relationship which the loan must have to a taxpayer's business was explained in the *House Committee Report* on page 431 of C.B. 1942-2 as follows:

> "* * * The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. *If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at*

exchange of capital asset held for not more than 6 months, rather than of a capital asset held for not more than 15 months. This change is made in view of corresponding changes made in section 136 of the House Bill (amending section 117 of the Code, relating to capital gains and losses) in order that losses resulting from the worthlessness of non-business bad debts may be treated in the same manner as short-term capital losses are treated under section 117 of the Code. In addition, the provisions with respect to non-business bad debts are now made applicable only to taxable years beginning after December 31, 1942." 1942-2, C.B. p. 574.

[3] 26 USCA, Section 23(e) IRC 1939: Losses by individuals. In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

1. if incurred in trade or business; or
2. if incurred in any transaction entered into for profit, though not connected with the trade or business.

at the time the debt becomes worthless, the debt is not a nonbusiness debt for the purposes of this amendment." (Emphasis supplied)

The Committee then went on to give illustrations of debts which were incurred in what was obviously a business transaction to show how the time of the debt's becoming worthless would control in determining its proximate relationship to the taxpayer's business.

In a case involving the very first year of applicability of Section 23(k)(4), 1943, the question of how proximate the relationship of the debt to a business of the taxpayer must be was raised and decided in the case of *Cluett v. Commissioner*, 8 T.C. 1178 (1947) Acq. 1947-2 C.B. 2. In that case, the taxpayer sold a one-fourth ownership in a stock exchange seat for $125,000 and took a note from the purchaser for $65,000. The purchaser subsequently went bankrupt leaving $28,985.97 owing on the note. The taxpayer deducted this sum as a business bad debt, and in allowing this as a business bad debt the court said:

> "The principal contention of the respondent seems to be that the loss from the bad debt in question did not arise in the ordinary course of the operation of a business involving the buying and selling of stock exchange seats. The petitioner does not contend that he was regularly engaged in any such business. Neither does he contend that the loss in question was one sustained in a usual transaction of any partnership of which he was a member. He contends, however, that the loss resulted directly from the operation of the business in which he was regularly engaged, both at the time the sale was made and at the time the debt became worthless, and, in the alternative, that the loss was at least proximately related to or connected with that business. * * *.

> The legislative history of sec. 23(k)(4) indicates that its principal purpose was to place a limitation upon losses from bad debts, such as loans to relatives or friends which had no connection with the business of the lender. * * * .
>
> The debt here in question was not the result of a loan by the petitioner to a friend or relative or an isolated transaction which bore no relation whatsoever to the business in which he was engaged, but, on the contrary, was closely related to the business of owning and using a stock exchange membership for the production of income, in which busines, the petitioner was engaged not only in 1929, when the debt was created, but also in 1943, when it became worthless. * * *."

It is significant to note that the Treasury Department acquiesced in the *Cluett* interpretation of the statute, 1947-2 C.B.(2).

The next case to pass on the meaning of Section 23(k)(4) was that of *Campbell v. Commissioner*, 11 TC 510 (1948), involving the taxable year 1944.

The three petitioners in the *Campbell* case had been engaged since 1929 in organizing, owning and operating corporations engaged in the retail coal business, which totalled 12 such corporations. It was their practice as a part of their business to advance to (or leave with) those corporations on open account money belonging to them in many different instances. One of those corporations was the Campbell Bros. Coal Co. of Akron. The loans to that company which were in question were similar to loans made to other of their companies.

The court in determining that the loss resulting from such worthlessness was a business bad debt denied the govern-

ment's claim that taxpayer's loss fell under Section 23(k)(4), stating:

> "* * * They were debts, the loss from the worthlessness of which was incurred in the taxpayers' business. A finding has been made that they were business rather than nonbusiness bad debts because the evidence shows that they had a direct connection with the business carried on by these petitioners and the losses were directly a result of, and incurred in, the business of organizing and operating corporations engaged in the retail coal business, which business of *organizing and operating* such corporations was carried on by the petitioners during the taxable year. These are not cases in which losses of corporations are being confused with losses of individuals or in which the business of a corporation is being confused with the business of individuals. Nor are they like net loss carryover cases in which loss occurred in isolated transactions rather than in the operation of a business. * * *." (Emphasis supplied)

The Commissioner also acquiesced in this case decided in 1948, 1949-1 CB (1).

The Treasury's acquiescence in the *Cluett* and *Campbell* cases (supra) has never been withdrawn.

Closely following the *Campbell* case (supra) was the decision in the case of *Macy v. Commissioner*, 8 TCM 45, decided January 18, 1949, in which it was held that where a person invests in a number of businesses and *takes part in their management* over and above passively giving financial aid, he is in the business of investing and personally participating in various ventures and is entitled to claim a business bad debt deduction.

Petitioner in that case was engaged in the development of new business ventures and the organization and management of various corporations. In 1929 and 1930, he became interested in the development of a company for the manufacture of fountain pens and loaned substantial amounts of money to this company, which ultimately became bad debts. In holding that the petitioner's debt was a business bad debt within Sec. 23(k)(1) the court quoted from the case of *Foss v. Commissioner*, (1 Cir.) 75 F. 2d 326, 35-1 USTC, para. 9091, as follows:

> "The line comes between those who take the position of *passive investors*, doing only what is necessary from an investment point of view and those who associate themselves actively in the enterprises in which they are financially interested and devote a substantial part of their time to that work as a matter of business." (Emphasis supplied)

The "more than a passive investor" test of *Foss v. Commissioner* (supra) adopted by the Tax Court in the *Macy* case (supra) had been laid down in 1935 in a situation where the Commissioner, admitting that certain attorneys fees paid by the taxpayer were reasonable and necessary, had denied that they had been incurred "in carrying on any trade or business", under a Section of the Code which was substantially equivalent to Section 23(a)[4] of the 1939 Code existing at the time of the *Macy* decision.

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[4] 26 USC, Sec. 23 IRC 1939: Deductions from gross income. In computing net income there shall be allowed as deductions:
(a) Expenses.
(1) Trade or business expenses.
(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

The court in the *Foss* case in citing *Washburn v. Commissioner*, (8 Cir.) 51 F. 2d 949, 2 USTC, para. 794, with approval said:

> "In *Washburn v. Commissioner* (8th Cir.) 51 F. 2d 949, the petitioner's activities resembled those of Foss. He was a retired lawyer who gave his whole time to enterprises in which he had investments. It was held that he was engaged in business. We agree with that decision. A person of property, who devotes his time to the *active management of it* and also to active participation in the management of the companies in which his property is invested, and who maintains an office for that purpose where he spends a substantial part of his time, is carrying on business within the meaning of this statute." (Emphasis supplied)

Averill v. Commissioner, 20 BTA 1196, cited in the *Macy* case involved what constituted trade or business for the purpose of a loss carry-forward.[5]

The *Foss*, *Washburn* and *Averill* cases (supra) cited in the *Macy* decision were all ones involving sections of the Code other than 23(k)(4) and 23(e)(1), because at the

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[5] The taxpayer, Averill, was one of large resources, actively engaged in many businesses operated in his city who devoted the usual business hours of each day to his affairs, maintaining an office and employees. It was his practice to operate each business venture through a corporation and not a personal venture. Through the failure of one of such corporations, he sustained a loss in 1922. The court held: "He was not content merely to invest his money in stocks and bonds in corporations managed by others, taking the inactive interest generally shown by such investors. He directed his efforts to getting good men to manage the various enterprises in which he was interested and to so diversify and carry on the businesses that one would help another. He received salaries from several of these corporations as an officer, and he frequently consulted and advised with all of them. These activities constituted petitioner's business."

time, *Campbell v. Commissioner*, 11 T.C. 510, was the only decision involving the taxpayer's organizing, managing and financing of corporations under 23(k)(4) and there were apparently none under 23(e)(1).

Congress's intention in relating Section 23(k)(4) to Section 23(e)(1) was interpreted in the case of *Commissioner v. Smith* (2 Cir.) 203 F. 2d 310; 53-1 USTC para. 9317. There the taxpayer had no history of organizing corporations and admitted he was not in the business of lending money. However, he had advanced sums to several enterprises in which he had invested and tried to sustain his case on the broad definition of "business" in *Flint v. Stone Tracy Co.* 220 U. S. 107, 55 L. Ed. 389.

The court, in effect holding that such an interpretation would be a blurring of the distinction between Section 23(e)(1) and 23(e)(2) stated that Section 23(k)(4)'s definition of "business" was not the "transaction entered into for profit" referred to in Section 23(e)(2) and summarized the Congressional History as follows:

> "When in 1942 Congress amended Section 23(k) to provide for different treatment of nonbusiness bad debts from that accorded such losses when incurred in a trade or business, the committee reports in both houses stated that the determination whether a debt is incurred in a trade or business is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23(e) is 'incurred in trade or business' under paragraph (1) of that section. 1942-2 Cum. Bull. 573. Section 23(e), dealing in general with losses sustained by individuals, explicitly establishes a distinction between losses incurred in trade or business and those stemming from 'any transaction entered into for profit, though

> not connected with the trade or business.' With this guide to the interpretation of Section 23(k), it becomes apparent that Congress did not adopt the broad definition of 'business' in *Flint v. Stone Tracy Co.*, 220 U.S. 107, 171, on which respondent relies."

On January 31, 1949, the Court of Appeals for the Ninth Circuit rendered a decision in the case of *Maloney v. Spencer*, (9 Cir.) 172 F. 2d 638; 49-1 USTC para. 9176, involving a question of whether an advance to a controlled corporation was a loss suffered in "the taxpayers trade or business."

In the *Maloney v. Spencer* case the taxpayer was the owner or lessee of three plants in which he carried on fruit, dairy and vegetable packing, canning and dehydrating operations. He formed three separate corporations to take over such operations, in which corporations he was the sole stockholder except for qualifying shares held by the Directors. In connection with his leases to these corporations, he provided financing of their operations through personal guaranty and pledge of property owned by him over a period of 3 years. The taxpayer improved the plants and spent about one-third of his time in performing activities as landlord.

In holding the taxpayer to be engaged in the business of acquiring, owning, expanding, equipping and leasing food processing plants, the court stated:

> "Here the taxpayer's activities were 'extensive, varied, continuous and regular' as in *Daily Journal Co. v. Commissioner*, 135 F. 2d 687, 688 (Cir. 9), and *Miller v. Commissioner*, 102 F. 2d 476 (Cir. 9). Here is the frequency and continuity of 'the transaction' resulting in a business status of *Commissioner v. Boeing*, 106 F. 2d 305, 319 (Cir. 9), cert. den. 308 U.S. 619. Here the taxpayer was engaged in two businesses as in *Daily*

Journal Co. v. Commissioner, supra, 689, and *Harvey v. Commissioner*, No. 11823, decided January 3, 1949 (Cir. 9). Like the instant case are *Fackler v. Commissioner*, 133 F. 2d 509 (Cir. 6); *Kales v. Commissioner*, 101 F. 2d 35 (Cir. 6); *Foss v. Commissioner*, 75 F. 2d 326 (Cir. 1).

"Here is the 'regularity' as distinguished from the 'isolated or occasional transactions' of *Burnet v. Clark*, 287 U.S. 410 424-5, and *Dalton v. Bowers*, 287 U. S. 404. Also is the multiplicity of transactions required by the several leases creating a business obligation to the corporations as distinguished from the 'single transaction' occurring in the 'lifetime' of the taxpayer 'but once' of *Deputy v. Dupont*, 308 U.S. 488, 495."

In September, 1950, the Tax Court rendered the decision of *Sage v. Commissioner*, 15 T.C. 299, in which the petitioner outlined many separate activities in which he participated from the time he graduated from college in 1923 until about 1946. The court found he was always looking for opportunities to use his money and time. Some proved to be profitable, but most did not. The loans to Revenue Development Corporation, the subject of the bad debt loss, the court found were:

"like his aid to or investment in a number of other business ventures—each was accompanied by activity of the petitioner in the venture. This is not a case, like *Higgins v. Commissioner*, 312 U.S. 212, of a wealthy man claiming that the investing and reinvesting of a large fortune in marketable securities constitutes carrying on a business. The petitioner, no doubt, did some investing and reinvesting of his funds in marketable securities, but he does not refer to that part of his activities as a basis for his claim here. He mentions only

> ventures of a different character in which he assumed greater risks and in which he actually participated, or hoped to participate through personal services. * * * He did not merely invest his money but used his time and energy to make the venture succeed."

In allowing the petitioner Sage the deduction, the court stated "He did that sort of thing with such frequency and regularity that it amounted to a regular business carried on by him" and went on to state:

> "The working assets of his business were his money and his personal services. He used them consistently and repeatedly. If one venture was successful, he continued with it, but if it failed, he dropped it. He continued to look for other opportunities. His business was not merely that of a particular venture. Cf. *Burnet v. Clark*, 287 U. S. 410. He was *not a passive investor*. The Revenue Development Corporation venture was not an isolated transaction but was a part of his regular business and the loss from that venture was incurred in *the operation of a business regularly carried on by him*. Cf. *Washburn v. Commissioner*, 51 F. 2d 949; *T. I. Crane*, 17 B.T.A. 720." (Emphasis supplied.)

The *Sage* case was acquiesced in by the Commissioner, 1951-1 CB 3.

Another case decided upon the law as it existed immediately prior to the passage of the Revenue Act of 1954 as to what constitutes a trade or business under Section 23(k)(4) was *Commissioner v. Stokes' Estate*, (3 Cir.) 200 F. 2d 637, 53-1 USTC para. 9164, decided in January 1953. The court held that the taxpayer's loss suffered from a loan to one of the corporations he had formed was a business bad

debt within Sec. 23(k)(1) and characterized his activities in organizing, investing in and managing corporations as follows:

> "It was quite clearly a personal activity in which a major portion of the decedent's lifetime, thought and energy was enlisted and in which he engaged continuously and regularly throughout his business career. In these respects this case differs from those relied on by the Commissioner and resembles *Maloney v. Spencer*, (9 Cir.) 1949, 172 F. 2d 638, 640; *Vincent C. Campbell v. Commissioner*, 1948 11 T.C. 610, acq. 1949-1 C.B. 1; and *Henry F. Sage v. Commissioner*, 1950, 15 T. C. 299, acq. 1951-1 C.B. 3, in which cases activities in many respects similar to those here were held to be business activities. And see *Robert Cluett, 3rd v. Commissioner*, 1947, 8 T.C. 1178, acq. 1947-2 C.B. 2."

Therefore, at the time of the enactment of the Internal Revenue Code of 1954, a complete revision of the tax law both as to substance and form, the courts had consistently recognized that the activities of a taxpayer in regularly and continuously organizing and actively managing corporations constituted the carrying on of a business within the meaning of Section 23(k).

Or in other words, to use the test, laid down by *Foss v. Commissioner*, (1 Cir.) 75 F.2d 326, 35-1 USTC para. 9091, as quoted in *Macy v. Petitioner*, 8 TCM 45; again reiterated in *Sage v. Commissioner*, 15 T.C. 299, and in essence followed in *Commissioners v. Stokes' Estate*, 200 F. 2d 637, 53-1 USTC para. 9164, the question is whether the taxpayer is *"more than a passive investor"*.

B. Enactment of Internal Revenue Code of 1954 Confirmed Prior Decisions

The reenactment by Congress without significant change of Sections 23(k)(1) and 23(k)(4) into Sections 166(a)[6] and 166(d)[7] of the Internal Revenue Code of 1954 could certainly be considered as a clear affirmation of the "more than a passive investor" rule first laid down in the *Foss*[8] case and the interpretation given Section 23(k) by the *Campbell*[9], *Macy*[10], *Sage*[11] *Maloney*[12], and *Stokes*[13], decisions.

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[6] Subsection (a) contains the general rule for the treatment of bad debts found in section 23(k)(1) of the 1939 Code. No substantive change is made.

[7] The only substantive change was made to liberalize the allowance of business bad debt treatment. (83d Cong., 2d Sess., S. Rep. No. 1622 (1954) 199): "Subsection (d) relating to nonbusiness bad debts of taxpayers other than corporations incorporates provisions contained in section 23(k)(4) of the 1939 Code with certain substantive changes. Nonbusiness bad debts continue to be treated as short-term capital losses. Two types of indebtedness are specificially excluded from the definition of nonbusiness bad debts. First, debts which become worthless in the course of the trade or business of the taxpayer. This is the only type of indebtedness which was excluded from the definition of nonbusiness bad debt under existing law. Second, any debt which is either created in the course of the trade or business of the taxpayer or is acquired by him in the course thereof without regard to the relationship of the debt to a trade or business of the taxpayer at the time that the debt becomes worthless, shall not be treated as a nonbusiness bad debt."

[8] 75 F. 2d 326, 35-1 USTC para. 9091.

[9] 11 TC 510.

[10] 8 TCM 45.

[11] 15 TC 299.

[12] 172 F. 2d 638, 49-1 USTC para. 9176.

[13] 200 F. 2d 637, 53-1 USTC para. 9164.

One of the first cases decided after the enactment of the 1954 Code, *Scott v. Commissioner*, 14 TCM 1029, T. C. Memo 1955-258, decided September 16, 1955, allowed a business bad debt deduction to a taxpayer who had formed and loaned money to some 12 or 13 corporations to one of which he made the loan which was the subject of the bad debt in question, citing as authority *Sage v. Commissioner*, 15 T.C. 299; *Campbell v. Commissioner*, 11 T.C. 510; *Maloney v. Spencer*, 172 F. 2d 638; 49-1 USTC para. 9176.

In the case of *Giblin v. Commissioner*, (5 Cir.) 227 F. 2d 692; 56-1 USTC para. 9103, decided November, 1955, the Court of Appeals for the Fifth Circuit, in reversing the Tax Court's holding that the petitioner was not engaged in business within the meaning of Section 23(k)(4), stated:

> "Both the Tax Court and Courts of Appeals have recognized the type of activity engaged in by petitioner as satisfying the requirement of 'carrying on a trade or business' when such activity has been sufficiently extensive to warrant the conclusion that the individual involved is *more than a passive investor. Foss v. Commissioner of Internal Revenue*, (1 Cir.) 76 (75) F. 2d 326; *Maloney v. Spencer*, (9th Cir.) 172 F. 2d 638; *Commissioner of Internal Revenue v. Stokes' Estate*, (3 Cir.) 200 F. 2d 637; *Henry E. Sage v. Commissioner of Internal Revenue*, 15 T.C. 299; *Charles H. Scott and Wife v. Commissioner of Internal Revenue*, 14 T.C. 1029, decided September 16, 1955." (Emphasis supplied)

A year later this Honorable Court decided the case of *Putnam v. Commissioner*, 352 U.S. 82; 1 L.Ed. 2d 144, which as far as we know is the only other time that it has

been called upon to pass upon Section 23(k)(4) IRC 1939. Whereas there the facts and the issues[14] were so different as to prevent the holding from being applicable to the case before the Court now, its comments on the legislative history of the Section of course should be given full consideration. The Court said:

> "The section was part of the comprehensive tax program enacted by the Revenue Act of 1942 to increase the national revenue to further the prosecution of the great war in which we were then engaged. It was also a means for minimizing the revenue losses attributable to the fraudulent practices of taxpayers who made to relatives and friends gifts disguised as loans. Equally, however, the plan was suited to put non-business *investments* in the form of loans on a footing with other non-business *investments.*" (Emphasis supplied)

In December, 1959, the Court of Appeals for the Sixth Circuit in the case of *Mays v. Commissioner* (6 Cir.) 272 F. 2d 788; 60-1 USTC para. 9122, in reversing the Tax Court, held that loans to corporations operating retail outlets made by the taxpayers in order to expand their wholesale cigar distributing corporations were business bad debts within the meaning of Section 23(k).

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[14] In the Putnam case the question was whether a loss occasioned by the taxpayer, a lawyer who showed no history of organizing, managing or financing corporations but who had guaranteed an obligation of a publishing corporation which he had formed, was to be treated as a bad debt under Section 23(k)(4) or as a loss sustained in a transaction entered into for profit not connected with business under Section 23(e)(2). Rev. Rul. 60-48, 1960-1 CB112, makes it clear that the **Putnam** decision merely stands for the proposition that a noncorporate guarantor of a corporate indebtedness has a bad debt deduction, rather than an ordinary business loss, and that the question of whether the payment of the guaranty results in a business or a nonbusiness bad debt is dependent upon the facts of each case. 63 CCH par. 1627.461.

The Court in so holding stated the rule of law as follows:

> "Mere participation in a corporate venture by owning stock, as an investment, does not place one in the business which the corporation carries on. An individual taxpayer is not allowed to override the corporate entity and take unto himself the tax benefit of Section 23(k)(1), unless the debt bears a proximate relationship to the taxpayer's own true business as distinguished from that of the corporation. *Commissioner v. Stokes' Estate*, 200 F. 2d 637 (C.A. 3). But, where a person invests in a number of entities appertaining to his own business and takes part in their management beyond passively giving financial aid, a bad debt loss to one of the businesses is incident to his regular vocation and is not the result of an isolated investment."

The Court also cited as authority for its holding *Maloney v. Spencer*, (9 Cir.), 172 F. 2d 638, 49-1 USTC para. 9176 and *Campbell v. Commissioner*, 11 T.C. 510.

In the recent case of *Maytag v. U. S.* (U. S. Court of Claims, 1961), 289 F. 2d 647, 61-1 USTC para. 9424, the Court of Claims held that the taxpayer had suffered a business bad debt loss in a transaction which the taxpayer described as being "one feature of his general business of carrying on activities connected with the airplane industry" The Court in holding for the taxpayer stated:

> "Since 1947, when he was 21 years old, the plaintiff has been engaged solely in business connected with aviation * * *. During the years 1951 to 1956 the plaintiff caused four other corporations to be formed. Their nature is described in finding 8. Their activities were exclusively in the field of aviation and aviation equipment.

"* * * They show, we think, that the plaintiff's business was a myriad of activities, all directly connected with aviation, which could be owned as elatively small business enterprises without involving outside capital in large amounts. The plaintiff, for reasons satisfactory to him carried on these enterprises in corporate form. He was not involved in these corporations merely as an investor * * *. Our conclusion is that these activities were his business and the bad debt which he seeks to deduct was a business bad debt."

In each of the foregoing cases[15] decided since the enactment of the 1954 Code, the "more than a passive investor" rule of *Foss v. Commissioner* (1 Cir.), 75 F. 2d 326, 35-1 USTC para. 9091, was recognized and acknowleged to be the test of whether the taxpayer was carrying on a trade or business. However, due to the insertion of some unfortunate and superfluous language as dicta in *Giblin v. Commissioner* (5 Cir.), 227 F. 2d 693, 56-1 USTC para. 9103, the Courts of Appeals of two Circuits, and certain of the later Tax Court cases, have commenced the imposition of an additional requirement, namely that the taxpayer must have organized the corporations for sale. This was not contemplated by Congress and makes a radical departure from established law.[16]

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[15] See also **Glenn Alexander v. Commissioner,** 71 TC 758, decided July 29, 1960 which cited **Campbell v. Commissioner,** 11 TC 510 with approval.

[16] **Campbell v. Commisioner,** 11 TC 510.
Maloney v. Spencer, (9 Cir.) 172 F. 2d 638, 49-1 USTC para. 9176.
Macy v. Commissioner, 8 TCM 45.
Sage v. Commissioner, 15 TC 299.
Commissioner v. Stokes' Estate, (3) Cir.) 200 F. 2d 637, 53-1 USTC para. 9164.
Scott v. Commissioner, 14 TCM 1329, TCMemo 1955-278.

Second Point (Restated)

The majority of the Court of Appeals for the Fifth Circuit erred in affirming the holding of the Tax Court that the taxpayer in order to deduct as a business bad debt one of many loans made in the course of his extensive activities in organizing, managing and financing numerous corporations, must also prove that he was a person who had formed the corporations for the purpose of selling them.

The basic error of the Tax Court, which was affirmed by the Court of Appeals in the case below, was its holding that Petitioner, A. J. Whipple, in order to deduct as a business bad debt one of many loans in the course of his business of organizing, managing and financing numerous corporations, must also prove that he was a *promoter* who had formed the corporations for the *purpose of selling them.*[1]

Such a rule, as was shown in detail under the First Point was not the intent of Congress, is in conflict with the decision in every case decided from the date of the enactment of Section 23(k)(4) to June, 1958, and is contrary to the great weight of authority since that time.

In all of the following cases business bad debt treatment was allowed to a taxpayer who showed no evidence whatever of having formed corporations for sale: *Campbell v. Commissioner*, 11 T.C. 510; *Mays v. Commissioner*, (6 Cir.) 272 F. 2d 788, 60-1 USTC para. 9122; *Maloney*

[1] See statement by the Tax Court (R. 31) that Petitioner did not "* * * develop them for sale as a going business to customers in the course of the business of promoting."

v. Spencer, (9 Cir.) 172 F. 2d 638, 49-1 USTC, para. 9176; *Commissioner v. Stokes' Estate*, (3 Cir.) 200 F. 2d 637, 53-1 USTC, para. 9164; *Sage v. Commissioner*, 15 TC 299; *Scott v. Commissioner*, 14 TCM 1029; *Alexander v. Commissioner*, 34 TC 758; and the recent cases of *Trent v. Commissioner* (2 Cir.), 291 F. 2d 669, 61-2 USTC para. 9506, reversing 34 TC 910 and *L. B. Maytag, Jr. v. U. S.* (U. S. Court of Claims), 289 F. 2d 647, 61-1 USTC para. 9424. Also see the case of *Giblin v. Commissioner* (5 Cir.), 227 F. 2d 692, 56-1 USTC para. 9103.

These cases, for the most part, were based on the earlier rule laid down in *Washburn v. Commissioner* (8 Cir.), 51 F. 2d 949; 2 USTC para. 794; allowing a net operating loss carry forward from 1922 to the year 1923 and *Foss v. Commissioner* (1 Cir.), 75 F. 2d 692; 35-1 USTC para. 9091, allowing a deduction of certain expenses as being incurred in the business of actively participating in the management of a number of corporations. Neither were cases of taxpayers who formed corporations for sale.

Apparently the Tax Court's mistake stems from its reliance on the case of *Holtz v. Commissioner*, (9 Cir.), 256 F. 2d 865, 58-2 USTC para. 9620.

The findings of the Tax Court, which were affirmed by the Court of Appeals, in the *Holtz* case (supra) as "not being clearly erroneous" were:

> "We do not think that the activities outlined herein are sufficiently extensive to establish the existence of a separate business of promoting, organizing, financ-

ing and managing businesses during 1950." 16 TCM 439.

The Court of Appeals in that case seized on the word "*promoting*" used by the Tax Court and treated it as being controlling, when in fact the controlling words in the Tax Court's holding were "We do not think that the activities outlined herein are sufficiently extensive *to establish the existence of a separate business.*"[2]

In distinguishing the cases which the petitioner was relying on, the Court of Appeals in the *Holtz* case (supra) made the following statement:

> "Petitioner relies on the line of cases which holds that a stockholder's loan to one of his corporations may qualify as a business bad debt if the stockholder was engaged in *promoting*, organizing, financing and managing business enterprises, or in other words was en-

[2] It would appear that the Tax Court in this Whipple case below was following the same erroneous reasoning when it made the statement:

> "What petitioner fails to recognize is the distinction between carrying on one's business through a corporate form, which, of course, requires some organizing and financing, and the business of dealing in corporations, which may likewise require some financing arrangements. **Holtz v. Commissioner,** (C.A. 9) 256 F. 2d 865, 870, affirming T.C. Memo. 1957-106."

It might be more accurately stated what the Tax Court failed to recognize is the distinction drawn in the numerous cases cited in the First Point between the business of organizing, managing and financing corporations separate and distinct from the corporation and the particular business being conducted by the corporation itself. **Campbell,** 11 TC 510, **Scott,** 14 TCM 1029, TC Memo 1955-258, **Sage,** 15 TC 299, **Macy,** 8 TCM 45, **Averill,** 20 BTA 1196, **Stokes',** 200 F. 2d 637, 53-1, USTC para. 9164, **Giblin,** 227 F. 2d 692, 56-1 USTC para. 9103, **Mays,** 272 F. 2d 788, 60-1 USTC para. 9122, **Alexander,** 34 TC 758, following the rules of **Foss,** 75 F. 2d 326, 35-1 USTC para. 9091.

gaged in the business of being a *promoter*. Petitioner unsuccessfully seeks to bring himself within the facts of certain of the *promoter* cases. Each of those cases is distinguishable."

The Court then proceeded to misinterpret the long standing decision of *Campbell v. Commissioner*, 11 TC 510 (1948).[3] Actually the Court in the *Holtz* case went so far as to misquote the opinion of the court in the *Campbell* decision as follows:

> "And in Campbell v. C.I.R., 1948, 11 T.C. 510 (CCH Dec. 16, 611), there was an express finding that the taxpayers were engaged in the business of *promoting*, financing, organizing and managing corporations to operate coal mines and therefore loans to the corporations were in the taxpayers' trade or business of promoting. * * *" (Emphasis supplied).

In not a single line of the whole opinion of *Campbell v. Commissioner* (supra) does the word 'promoting' appear. To the contrary, the court found that the bad debt loss

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[3] In **Campbell v. Commissioner**, the Court found that the loss on a loan made to one of twelve corporations organized by the taxpayer to engage in the retail coal business was a business bad debt stating:

> "They were business rather than nonbusiness bad debts because the evidence shows that they had a direct connection with the business carried on by these petitioners and the losses were directly a result of, and incurred in, the **business of organizing and operating corporations** engaged in the retail coal business, which business of organizing and operating such corporations was carried on by the petitioners during the taxable year. These are **not** cases in which losses of corporations are being confused with losses of individuals or in which the business of corporations is being confused with the business of individuals." (Emphasis supplied).

suffered by Campbell was incurred by one in the business of organizing and *operating* corporations.

The Court of Appeals in *Holtz v. Commissioner* (supra) seized upon similar loose language used as dictum in *Giblin v. Commissioner*, (5 Cir.) 227 F. 2d 692, 56-1 USTC para. 9103, to distinguish it as follows:

> "The *Giblin* case contains a clear finding of fact that the taxpayer was engaged in the business of 'seeking out business opportunities, promoting, organizing and financing them, contributing to them substantially fifty percent of his time and energy and then *disposing of them at a profit or loss.*'"

Then again, the Court citing from a *footnote* in the case of *Pokress v. Commissioner*[4] said:

> "As the Fifth Circuit recently said in distinguishing the *Giblin* case 'Petitioner was not engaged in the business of *dealing in enterprises*. Pokress v. CIR.'"

This conclusion that "dealing in enterprises" means forming corporations for sale seems to be arrived at by the reasoning that "dealing" implies "dealer" and "dealer" implies "selling". This is rather tenuous reasoning to use as the basis for the upsetting of a long established and sound legal standard.

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[4] (5 Cir.) 234 F. 2d 146; 56-2 USTC para. 9610. Actually the **Pokress** case (supra) was one involving a taxpayer who had found himself forced into investing in one corporation and later to lending it money to protect his investment. There was no evidence of his ever having formed a corporation at all and was indeed not a "dealer in enterprises" by any definition and certainly not a person engaged in managing corporations.

As can be seen, the other cases relied upon by the Tax Court below were the result of this same misinterpretation and basic error in application of the correct legal principles.

The second decision cited by the Tax Court below, *H. Beale Rollins*, 32 T.C. 604, aff'd (4 Cir.) 276 F. 2d 368, 60-1 USTC para. 9357, contains the following language:

> "* * * At no point is there any indication that petitioner considered *disposing* of any one of the segments of this profitable enterprise following their successful 'promotional' or organizational phase * * *." (Emphasis supplied).

Further evidence of the confusion incident to the erroneous interpretation of the holding in the *Giblin* case (supra) is demonstrated by the opinion of the Court of Appeals for the Fourth Circuit in *Rollins v. Commissioner* (4 Cir.) 276 F. 2d 368, 60-1 USTC para. 9357.[5]

In the next case relied on by the Tax Court below, *Vreeland v. Commissioner*, 31 TC 78, in an opinion

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[5] The decision of the Tax Court in that case was cited by the Tax Court in this case below as requiring that the corporations organized, financed and managed by the taxpayer must have been developed for sale. While basing its affirmance upon other grounds, the Court of Appeals for the Fourth Circuit in the **Rollins** case approved such a requirement only as an element to be considered rather than as a **controlling** test, saying:

> "Moreover, unlike the **Giblin** case, the Tax Court here pointedly noted the absence of evidence that the taxpayer had ever disposed of any business either at a profit or loss, after completing his asserted promotional and organizational activities —a circumstance that is not controlling but is entitled to consideration."

by the same justice as in this case below, the Tax Court showed it was also following the same erroneous thinking, by the statement:

> "* * * Had he done so (had the intent to build up corporations and eventually dispose of them) they would have been held by him *for sale* to customers in the ordinary course of his business." (Emphasis supplied)

Since the Court of Appeals in *Holtz v. Commissioner* (9 Cir.) 256 F. 2d 865, 58-2 USTC para. 9620, interpreted the case of *Giblin v. Commissioner* (5 Cir.) 227 F. 2d 692; 56-1 USTC para. 9103, to be based on the taxpayer's being in the business of promoting, organizing and financing corporations, and then "disposing of them at a profit or loss", Petitioner secured the complete transcript of the *Giblin* case to determine what the facts of the *Giblin* case really were. The record and the opinion of the *Giblin* case do not show that the decision was based on the grounds set forth in the *Holtz* (supra) opinion.

First, Petitioner submits that it is incorrect to state that there was such a finding of fact by the Court in the *Giblin* case.

Taxpayer's petition to the Tax Court, which as one of the attorneys of record he presumably had a part in drafting, stated: "Petitioner was * * * engaged in organizing, financing, managing and operating corporations and other enterprises so as to constitute a business". Nowhere does such petition mention "promoting", but even if after all the evidence were in the court found the word "promoter" to be a proper one to describe Mr. Giblin, it does not mean that he must have promoted these enterprises for sale. He could

have (and in fact did) promote them "to provide himself with an avenue of escape from the practice of law". This implies a desire to find a business which would provide him with a permanent source of income that would make it unnecessary for him to keep working at the law.

Whereas, the record shows that Giblin's interests in a few enterprises organized by him were sold at a profit, and the disposal of some others were forced on him by losses. *Nowhere in his eleven pages of testimony before the Tax Court* did he state an intent of having formed such enterprises for sale. Furthermore, six, including the one in which he suffered the loss in question, of the most important of Giblin's businesses mentioned in the opinion appear to have been formed to operate, and another one did not involve sales.[6]

The Court in the *Giblin* case, was certainly not laying down the requirement that corporations must be formed *for sale* as the correct legal standard when it stated:

> "Both the Tax Court and the Courts of Appeals have recognized the type of activity engaged in by petitioner as satisfying the requirement of 'carrying on any trade or business' when such activity has been sufficiently extensive to warrant the conclusion that the individual involved is *more than a passive investor.*" (Emphasis supplied) Citing *Foss v. Commissioner*, (1 Cir.), 75 F. 2d

[6] Furthermore, an examination of the record in the **Giblin** case shows that nearly all of his ventures were failures and that he disposed of them in the same manner as Petitioner, by realizing what he could from their liquidation. His two profitable ventures were put out of business by a change in the State law. These also were forced liquidations. The record in **Giblin** fails to show that he disposed of any profitable enterprises voluntarily, except stock in one corporation owning a lease, which was sold to an associate. The entire record shows that Giblin sold only to terminate a losing venture or one no longer legal.

326, 35-1 USTC Para. 9091, *Maloney v. Spencer*, (9 Cir.) 172 F. 2d, 638, 49-1 USTC para. 9176, *Commissioner v. Stokes' Estate*, (3 Cir.) 200 F. 2d 637, 53-1 USTC para. 9164, *Sage v. Commissioner*, 15 TC 299; and *Scott v. Commissioner*, 14 TCM 1029, TC Memo 1955-258."

Not one of these cases cited involved the formation of a corporation for sale.

In spite of this, the majority of the Court of Appeals for the Fifth Circuit in this case below affirmed the erroneous rule of law used by the Tax Court by citing (R. 135) the language of the *Giblin* (supra) and *Holtz* (supra) cases to the effect that Petitioner, A. J. Whipple, was not in the business of "disposing of his corporations at a profit or loss" nor a "dealer in enterprises" as a basis for it decision.

Whether it was the holding of *Giblin v. Commissioner* (supra) or its misinterpretation by the Court in *Holtz v. Commissioner* (supra) or the language in the footnote in *Pokress v. Commissioner* (supra) this imposition of the requirement that the corporations be organized for sale results in the addition of a new criteria never before appearing in any of the cases involving the question of whether the taxpayer was engaged in trade or business, from *Washburn v. Commissioner* (8 Cir.) 51 F. 2d 949, 2 USTC para. 794, decided in August, 1931, to *Giblin v. Commissioner* (supra) decided in November, 1955.

Or as Judge Hutcheson puts it so well in his dissent (R. 142):

> "Yet the government contends, and the Tax Court and the majority have erroneously held, that in order for a loss to be deductible, taxpayer Whipple must show

that the numerous corporate enterprises which he promoted, financed and managed, were formed by him for sale. This extension of the restriction on the qualification of business bad debts contended for by the Commissioner and the Tax Court considerably restricts the remedy which Congress provided for curing the mischief it had in mind. I think it clear that such restriction was never contemplated by Congress. Indeed the contention pressed here emasculates a clearly intended remedial law.

Looking at the question in the light of the language of the act and its legislative history, I am in no doubt that the Tax Court was wrong in citing and relying on cases to the contrary of these views for such a restrictive and defeating construction."

The extent of the Court's departure from the established rule is also pointed up by Judge Hutcheson in the concluding paragraph of his dissent where he stated (R. 143):

"It seems to me that the basic fault of the majority opinion is in holding, as it in effect does, that business bad debt treatment must be denied the taxpayer here because the loan was to a corporation in which he was interested. This holding is, in my opinion, a clear addition to the taxing statute. If congress had so intended, it could and would have so provided. Not having done so, neither the tax court nor this court can construe the statute as though it contained such provision."

Such is certainly not the law, and the case of *Scott v. Commissioner*, 14 TCM 1029, TC Memo 1955-258, is authority for the contrary.[7]

[7] See also **Campbell v. Commissioner**, 11 TC 510, **Maloney v. Spencer**, (9 Cir.) 256 F. 2d 865, 49-1 USTC para. 9620, **Sage v. Commissioner**, 15 TC 299, and **Mays v. Commissioner**, (6 Cir.) 272 F. 2d 778, 60-1 USTC para 9122.

This narrow thinking of requiring that corporations be formed *for sale* accounts for the Tax Court making so much of the fact that Petitioner in a prior year, 1951, had treated the sale of his equity interests in fourteen partnerships and corporations to his partner, at book value, as a capital gain, and for making the erroneous conclusion that he should necessarily, therefore, treat the losses suffered in 1953 from *loans* on open account made to entirely different corporations as capital losses. In comments made at the end of the trial (R. 127) the court said:

> "But primarily, the result of being in a business is the creation of ordinary income. It may be through salaries or it may be through the purchase and sale of property.
>
> "When as a result of a business it's the acquisition, properties acquisition in connection with the business, there is a sale, there is normally an ordinary gain and loss and not a capital. I don't imagine there would be anything further you want to ask this witness, but I gathered the impression that when the property was sold to which you referred that he acquired around 1949, 1950, and so on, that it was treated as capital gain, whereas, in the case of a true promoter, he makes his money either by being hired to do the promoting by some syndicate or other, from which he gets a salary and, therefore, the tax is ordinary income; or he makes his money by buying into interests and trying to sell them at a profit, in which case he would do so at ordinary income rates."

Then, in the opinion, the court states (R. 31):

> "* * * His purpose in forming the fourteen corporations was to facilitate his construction or real

estate business and not to develop them for sale as going businesses to customers in the course of the business of promoting, *H. Beale Rollins*, 32 T.C. 604, 615. Petitioner apparently entertained that opinion himself in the year 1951, when in his return for that year he reported the sale of twelve corporations and one partnership as a sale of capital assets. See *Thomas Reed Vreeland*, 31 T.C. 78. The evidence does not show that petitioner's business in 1953 was any different from 1951."

Petitioner's equity interests, in the form of stock in the many corporations and capital accounts in the partnerships which he sold to a dominant partner in 1951 in what he described as an across the board "liquidation" (R. 94) of his interests, many of which he had owned for as long as eight or nine years, were made as permanent investments as a part of his overall business activities.

It might be well to point out here that the taxable year 1951 is not in question in this proceeding. In any case, it most certainly does not follow that losses suffered in 1953 from loans to one of any entirely new set of corporations organized by him after the 1951 liquidation must necessarily be capital losses.

In the process of petitioner's organizing, financing and lending money, and operating corporations, he used his money in two ways. One was to buy stock as a permanent investment. The other was to *lend money temporarily* with the idea it would be *taken out and used again* in his business of organizing, financing, lending money to, and operating corporations and partnerships. This country has millions of permanent investors in stock in corporations, but they do not ordinarily lend these corporations money,

certainly not on open account. If they do, it is customarily in the form of a bond. Petitioner had a number of stockholders with permanent investments in his corporations and partnerships, but he was the *only* stockholder who the record shows loaned these 1951-1953 corporations and partnerships money. He was the one who furnished the real financing along with his activities in organizing and managing these corporations and partnerships. In doing so, he was certainly *more than a passive investor*.

Whatever Petitioner's intentions may have been as to the sale of Mission Orange Bottling Co., had it been successful, certainly his extensive activities from 1951 forward in putting together enterprises, forming corporations and financing and actively operating them were much more than those of a *passive investor*, and, as such, constituted a business, out of the conduct of which the $56,975.10 bad debt loss resulted.

Finally, the Tax Court erred in its thinking where, in its comments at the end of the trial (R. 127), it seemed to be limiting the possibility of a taxpayer's being in a trade or business, by requiring him to show that he was creating one of two types of ordinary income, stating:

> "It may be through salaries and it may be the purchase and sale of property."

Then later in its opinion the court limited it still further, to a showing of only one type of ordinary income, namely the proceeds from property which had been held for sale. (R. 31) Such a narrow ruling, we reiterate, is wrong as a matter of law. For instance, there are at least two other types of ordinary income that can be created as part of a business—interest and rental income.

The true test therefore is whether Petitioner was an investor who expected his investments to earn him a return, or was actively engaged in business activities from which he sought to create income from salaries, from interest, or from rent. The record shows that Petitioner, A. J. Whipple, was instrumental in generating income from all three.

Third Point (Restated)

The majority of the Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to find that Petitioner was in the business of acquiring, owning, expanding, equipping, leasing and renting real estate out of the conduct of which business the $56,975.10 bad debt resulted.

In the second paragraph of the opinion of the Tax Court below it is stated (R. 30):

> "Petitioner would have us find proximate relationship between the loss occasioned by the worthlessness of the debt due from Mission Orange and any one of three businesses in which he alleges he was individually engaged at the time of the loss. He contends that he was in the business of organizing, promoting, managing and financing corporations, general financing and lending of money, operating a bottling business, or all three."

In Petitioner's brief to the Tax Court the third point of argument relied upon was stated as follows:

> "Petitioner was engaged in the business of acquiring, owning, expanding, equipping and leasing bottling plants and other businesses."

And there was strong evidence to support such a proposition. In Petitioner's brief the close similarity between taxpayer, A. J. Whipple's case and that of the taxpayer in *Maloney v. Spencer*, (9 Cir.) 172 F. 2d 638, 49-1 USTC para. 9176 was brought out in detail. Yet, the Tax Court below completely ignored this theory of recovery.

The facts of th. leading case of *Maloney v. Spencer*, (supra) parallel those of the instant case very closely.

1(a) In *Maloney v. Spencer* the taxpayer organized three fruit, berry and vegetable packing and canning and dehydrating corporations, owned almost entirely by taxpayer, which operations were previously conducted by taxpayer individually.

1(b) In the instant case Petitioner organized a soft drink bottling corporation (R. 27) and later a soft drink distributorship corporation (R. 112-114) and a soft drink vending machine business (R. 114-115). Petitioner was the controlling and dominant owner of all three of these. (R. 27; R. 112-115).

2(a) In *Maloney v. Spencer* to further equip one plant the taxpayer bought adjoining land, and erected buildings equipped for canning, and leased it to the cannery corporations.

2(b) In the instant case, Petitioner bought land in the same city and erected a building on it, equipped it for bottling soft drinks, and leased it to the bottling corporation. (R. 28)

3(a) In *Maloney v. Spencer* the taxpayer agreed as part of the lease to provide adequate financing for the cannery business.

3(b) When Petitioner built his building for the bottling plant, he was already providing the bottling corporation with financing, having advanced $69,002.50, and it was implicit in the lease that he would continue to do so, which he did, in the amount of an additional $62,775.76.

4(a) In the case of *Maloney v. Spencer*, the taxpayer extended credit to the debtor corporation in numerous transactions, over a period of three years resulting in a balance of an open account that became the bad debt in question.

4(b) In the instant case Petitioner, A. J. Whipple, extended credit to the debtor corporation in numerous transactions, over a period of three years resulting in a balance of an open account that became the bad debt in question.

The court in the case of *Maloney v. Spencer* held that the taxpayer was engaged in the business of acquiring, owning, expanding, equipping, and leasing food processing plants, and stated:

> "Here the taxpayer's activities were 'extensive, varied, continuous and regular' as in *Daily Journal Co. v. Commissioner*, 9 Cir. 135 F. 2d 687, 688, and *Miller v. Commissioner*, 9 Cir. 102 F. 2d 476. Here is the 'frequency and continuity of the transaction resulting in a business status' of *Commissioner v. Boeing*, 9 Cir., 106 F. 2d 305, 319. certiorari denied, 308 U.S. 619, 60 S. Ct. 295, 84 L. Ed. 517. Here the taxpayer was engaged in two businesses as in *Daily Journal Co. v. Commissioner*, supra, 135 F. 2d 689, and *Harvey v. Commissioner*, 9 Cir., 171 F. 2d 952. Like the instant case are *Fackler v. Commissioner*, 6 Cir., 133 F. 2d 509; *Kales v. Commissioner*, 6 Cir., 101 F. 2d 35, 122, A.L.R. 211; *Foss v. Commissioner*, 1 Cir., 75 F. 2d 326.

> "Here is the 'regularity' as distinguished from the 'isolated or occasional transactions' of *Burnet v. Clark*, 287 U.S. 410, 424, 425, 53 S. Ct. 207, 77 L. Ed. 397, and *Dalton v. Bowers*, 287 U.S. 404, 53 S. Ct. 205, 77 L. Ed. 389. Also is the multiplicity of transactions required by the several leases creating a business obligation to the corporations as distinguished from the 'single transaction' occurring in the 'lifetime' of the taxpayer 'but once' of *Deputy v. DuPont*, 308 U.S. 488, 495, 60 S. Ct. 363, 84 L. Ed. 416."

The facts are even stronger in the instant case for the finding that Petitioner was in the business of acquiring, owning, expanding, equipping and leasing a bottling plant and other businesses.

Petitioner was in the real estate business aside from these bottling enterprises. (R. 47)[1] He had twice bought premises and equipped them for lumber yards, (R. 90-91; R. 101-102). Throughout 1951-1953 he was leasing land and buildings to Whipple Lumber Co. (R. 102-103; R. 106), and also had a rent house (R. 170; Exhibit 13-M). The Tax Court found that he acquired land in Pasadena, Angleton, Bellaire, and Houston, Texas, and engaged in sales activities with respect to such lands during 1951

[1] Stipulation 30 (R. 47). On January 14, 1954, petitioners filed a joint Declaration of Estimated Tax, Form 1040-ES, photostat of which is hereto attached, marked Exhibit 20-T1, and made a part hereof. On March 11, 1954 they also filed a joint individual income tax return, Form 1040, which is also attached, marked Exhibit 20-T and made a part hereof. In the schedules attached to the return income was shown as received by petitioner as follows:

Salaries from 6 corporations
Interest from 4 parties
One partnership
Rent from three properties

through 1953. (R. 26). Also he had formed an equipment rental corporation to lease equipment to lumber yards and construction companies. (R. 101).

The Tax Court found "Individually, petitioner was in the construction or real estate business". (R. 31).

Petitioner reported $15,570.58 net rentals in 1952 (R. 111; Exhibit 13-M; R. 154) and $12,225.19 in 1953 (R. 47; R. 111; Exhibit 20-T, R. 176) as ordinary income on his returns for those years. Had Mission Orange been successful he would have reported a great deal more rental income because of the ten year lease he had with it.

The Tax Court in its Findings of Fact (R. 28) states:

> "In 1952 petitioner erected a bottling plant on land which he purchased in Lubbock, Texas. The land and building costs a total of $43,601.70. On July 14, 1952, petitioner leased this plant to Mission Orange for a 10-year term, beginning August 1, 1952, with an option to renew. The prescribed rental was $500 per month for the first 3 years and $500 per month plus 1 per cent of gross sales thereafter. In his 1952 and 1953 return, petitioner claimed a deduction for depreciation of the bottling plant in Lubbock. These returns reflect that petitioner received no rent during either year for that building."

The reason, of course, that Petitioner did not collect the rent during these two years was that the debtor corporation could not afford to pay him. Since Petitioner's potential rental income was so substantial and the building cost him ($43,601.70), considerably more than he had invested ($31,800) in the bottling corporation, it

is reasonable to deduce that his advances made to Mission Orange Bottling Co. were to a significant degree to help it make his rental business profitable.

It was conceded early in tax law that activities in renting properties constituted a business. *Higgins v. Commissioner*, 312 U.S. 212, 85 L. Ed. 783.

Therefore, it is clear that Petitioner was in the business of acquiring, owning, expanding, equipping, leasing and renting real estate and equipment out of the conduct of which business the $56,975.10 bad debt resulted.

Whereas the case of *Maloney v. Spencer*, (9 Cir.) 172 F. 2d 638, 49-1 USTC para. 9176, involved the question of whether the taxpayer was in a business which would entitle him to carry back a net operating loss of $95,-081.48, the reasoning of the case would seem to apply even more strongly to a business bad debt loss. *Maloney v. Spencer* was cited as authority for business bad debt treatment in the cases of *Giblin v. Commissioner*, (5 Cir.), 227 F. 2d 692, 56-1 USTC para. 9103, *Commissioner v. Stokes' Estate* (3 Cir.), 200 F. 2d 637; 53-1 USTC para. 9164, *Scott v. Commissioner*, 14 T.C.M. 1028, *Mays v. Commissioner* (6 Cir.), 272 F. 2d 788; 60-1 USTC para. 9122; and *Trent v. Commissioner*, (2 Cir.), 291 F. 2d 669; 61-2 USTC para. 9506.

The majority of the Court of Appeals for the Fifth Circuit erred in failing to make any ruling on the fourth point urged by Petitioners in their Petition for Review and Assignments of Errors (R. 39) which read as follows:

> "The Tax Court of the United States erred in failing to make any finding as to petitioners' contention that

> Petitioner, A. J. Whipple was in the business of acquiring, owning, expanding, equipping and leasing bottling plants and other equipment out of the conduct of which business the $56,975.10 bad debt loss resulted in the calendar year 1953."

Since as pointed out above, the facts of the instant case clearly bring it within the rule of *Maloney v. Spencer* (supra) a recognized authority of long standing, the Tax Court and the Court of Appeals, by failing to sustain Petitioner's contention that he was entitled to treat the $56,975.10 loss as a business bad debt because it resulted in the conduct of his "business" as defined by *Maloney v. Spencer*, erred, which requires the reversal of this case.

Fourth Point (Restated)

The Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to hold that the extensive activities of the taxpayer in organizing, managing, operating, financing, lending, equipping and renting to corporations, partnerships and joint ventures constituted a business to which the $56,975.10 bad debt was proximately related.

The Tax Court and the majority of the Court of Appeals for the Fifth Circuit have applied too restrictive a legal standard in judging Petitioner, A. J. Whipple's activities which resulted in their incorrect determination that Petitioners $56,975.10 loss was a non-business bad debt.

In the far reaching and complicated life of America today, there are innumerable types of businesses and countless ways in which a debt becoming worthless may have a proximate relationship to the business activities, as distin-

guished from the investment activities, of taxpayers. The activities of Petitioner, A. J. Whipple, were both far-flung and complicated. Instead of looking at all these activities and trying to determine whether they were in fact business activities, as distinguished from investment activities, and whether the bad debt in question did indeed proximately relate to them, both the Tax Court and the Court of Appeals for the Fifth Circuit tried to narrowly compartmentalize Petitioner's activities and put an orthodox name tag on them.

The Tax Court and the Court of Appeals held that for Petitioner's loss to be treated as a business bad debt he must show that he was either (1) in the separate business of buying and selling corporations; or (2) in the separate business of lending money; or (3) in the business of actually bottling drinks.

Applying the facts to each of these completely independently and separately, the Courts below held that Petitioner did not fall into any one of these three narrow business categories. Therefore, by the application of such narrow standards Petitioner's $56,975.10 loss was determined not to be a business bad debt. This was clearly erroneous and based upon an erroneous construction of "trade or business" as used in Section 23(k)(4). It was pointed out in detail in the Third Point that both Courts below completely ignored one extensive business activity of Petitioner, that of rentals, on which there was substantial evidence submitted and which was vigorously urged before both Courts.

In addition, abundant evidence was introduced as to myriad of business activities, and it was urged that the com-

bination and cumulative effect of these activities clearly put them in the category of business activities as opposed to investment activities. The Tax Court while mentioning Petitioner's claim made no finding or holding thereon. The Court of Appeals did not even mention such a claim.

Petitioner, A. J. Whipple, introduced extensive evidence, and presented his case, both to the Tax Court and to the Court of Appeals for the Fifth Circuit in his brief, on the theory of five different, inter-related types of business activities, namely: (1) organizing, financing and managing corporations; (2) financing enterprises and lending money (3) the conduct of soft drink enterprises (4) the acquiring, owning, expanding, equipping and leasing bottling plants and other properties (5) a combination of these activities.

The Courts below took up a segregated examination of each of the first three of these grounds in turn, rejected each separately on its own facts without consideration of how the activities of the others might affect it, and then ignored the theories of the other two grounds entirely.

The activities of the Petitioner in *organizing* and *managing* corporations, partnerships and joint ventures extended over a period of time from the commencement of his business career in 1941 to and including the year 1953 in which the loss was sustained. This was done in conjunction with twenty-one different people and covered the following types of businesses: construction of houses, (R. 85) rental corporation, (R. 87) plumbing supply house, (R. 88) a tile distributorship, (R. 88) apartment houses (R. 89) a bottling business (R. 95) a retail lumber yard, (R. 90-91) a shingle distributorship, (R. 93) a retail building materials yard, (R. 97) an equipment rental corporation, (R. 101) club, (R. 104), a tile distributorship, (R. 25)

the subdivision of real estate and sale of lots in various towns, (R. 26) which involved putting in streets, sewers and water lines.

In addition the taxpayer bought and operated a restaurant, (R. 105) promoted oil ventures, (R. 65) organized a soft drinks distributorship, (R. 144), and entered into the vending machine business. (R. 115) He was brought other deals to help promote, raise money for and handle, such as the cinder block business in 1953, and the lumber yard promotion deal with Alex Head after that. (R. 66)

Attention is called to the description of the manner in which Petitioner, A. J. Whipple, promoted the tile distributorship (R. 88-89), to show the manner in which he operated.

In *Sage v. Commissioner*, 15 T.C. 299, the court in sustaining the business bad debt deduction gave a description of the taxpayers activities which might have been those of the Petitioner, A. J. Whipple:

> "* * * The petitioner has outlined many separate activities in which he participated from the time he was graduated from college until about 1946. There is testimony that he considered additional proposals which were brought to him at that time and that he was known as a person to whom such proposals might be brought profitably. Some of his activities may appear trivial and it may be inappropriate to fit some of the uses to which he put his time or money, or both, into the pattern of any business regularly carried on by him. But even if some of these are disregarded enough were left to show that he was regularly carrying on a business. There may be difficulty or differences of opinion in defining that business properly but it existed and was apparent. * * *"

In its findings of fact, the Tax Court below found that Petitioner was not in the business of organizing, promoting, managing or financing corporations and that he was not in the business of lending money. (R. 29). Petitioner submits that these were not in reality findings of fact, but legal conclusions, and therefore, are not in any way binding on this Honorable Court. As pointed out in 5 *Am. Jur. 2d*, page 268:

> "Findings of fact based upon an improper and incorrect jury instruction, *or upon the trial courts erroneous view of the law*, may be reviewed and set aside on appeal. * * * Where the finding of the trial judge was based on what, in the opinion of the appellate court, was a legally erroneous conception of the meaning to be attached to words in dispute, that finding although largely based on testimony given before the trial judge, will be disregarded by the appelate court." (Emphasis supplied)

Also in 5 *Am. Jur. 2d*, page 272:

> "The meaning of terms used in a statute or ordinance is generally a question of law."

The question of statutory construction is one of law to be reviewed and resolved by the courts. *Commissioner v. Bedford*, 325 U.S. 283, 292, 89 L.Ed. 1611, *Commissioner v. LoBue*, 351 U.S. 243, 247 100 L.Ed,. 1142. These standards have been recognized by the Supreme Court on numerous occasions as in *Bingham's Trust v. Commissioner*, 325 U.S. 365, 89 L.Ed. 1670, where the court said:

> "Since our decision in the *Dobson*[1] case we have frequently re-examined, as matters of law, determinations

[1] **Dobson v. Commission**, 320 U.S. 489, 88 L.Ed. 289.

> by the Tax Court of the meaning of the words of a statute as applied to facts found by that court. A question of law is not any the less such because the Tax Court's determination of it is right rather than wrong. Whether or not its decision is 'in accordance with law' is a question which the statutes, Internal Revenue Code Section 1141 (c) (1), 26 USCA 1940 Edition, Section 1141 (c) (1), 6 FCA Title 26, Section 1141 (c) (1) expressly makes subject to appellate review."

In the case of *Washburn v. Commissioner*, (8 Cir., 1931), 51 F. 2d 949, 2 USTC para. 794, in reversing the Board of Tax Appeals the court said:

> "The Board here found certain primary facts. It drew therefrom the ultimate conclusion that petitioner was not regularly engaged in trade or business under Section 204(a). This required a construction of Section 204(a) as applied to the facts. The question here is a mixed one of law and fact. * * * That there may be some degree of finality in a finding of fact by an administrative body may be conceded, but such finding cannot take from courts the power to construe a statute and determine whether it covers such a situation as the facts present."

The Second Circuit in *Commissioner v. Smith*, 203 F. 2d 310, 53-1 USTC para. 9317, in reversing the Tax Court's finding that the taxpayer's loss was a business bad debt under Section 23(k)[2] cited the *Washburn* case and said:

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[2] See also **Mays v. Commissioner**, (6 Cir.) 272 F. 2d 788; 60-1 USTC para. 9122, reversing the Tax Court's finding that the taxpayers loss was not a business bad debt within the meaning of Section 23(k).

> "But insofar as this determination involves the interpretation of the statutory language, it raises an issue of law in which the Tax Court's decision is subject to review here."

As shown under the First Point, at the time of the reenactment of Sections 23(k)(1) and 23(k)(4) into the 1954 Code without substantial change, the law as stated in the *Foss*[3], *Campbell*[4], *Sage*[5], *Stokes' Estate*[6], *Maloney*[7], and *Washburn*[8] cases was that the activities of a taxpayer in regularly and continuously organizing and actively managing corporations constituted the carrying on of a business within the meaning of 23(k) and loans made to one of such corporations which became worthless are business bad debts. To use the criteria laid down by *Foss v. Commissioner*, (1 Cir.) 75 F. 2d 326; 35-1 USTC para. 9091:

> "The line comes between those who take the position of *passive investors*, doing only what is necessary from an investment point of view, and those who associate themselves actively in the enterprises in which they are financially interested and devote a substantial part of their time to that work as a matter of business." (Emphasis supplied)

This therefore was and is the law and should have been the test applied to this taxpayer. As shown in Section B

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[3] 75 F. 2d 326, 35-1 USTC para. 9091.

[4] 11 T.C. 510.

[5] 15 T.C. 299.

[6] 200 F. 2d 637, 53-1 USTC para. 8164.

[7] 172 F. 2d 638, 49-1 USTC para. 9176.

[8] 51 F. 2d 949, 2 USTC para. 794.

of our First Point, the great weight of authority since the enactment of the 1954 Code has continued to recognize the *Foss* rule, but, as explained in our Second Point, through a misinterpretation of certain loosely used phrases, a few of the courts have begun the imposition of the additional requirement that the corporations must be organized for sale. These cases make a radical departure from the existing law, which clearly was not contemplated by Congress and is not based on sound income tax principles.

Had the proper rule of law been applied to the facts, as shown above, Petitioner would certainly qualify as having been in the business of regularly and continuously organizing and actively managing corporations. The Tax Court found that he had organized fifteen corporations. (R. 25, R. 26) He maintained his office at 2436 Bissonnet, and the home office of each of his enterprises was located there. He was the dominant stockholder in the various corporations and maintained a constant control.

During the year 1953, Petitioner was actively managing numerous other enterprises besides his concern with Mission Orange. He was operating a restaurant (R. 111), a lumber yard (R. 111) and an equipment rental corporation (R. 111), building houses (R. 11), renting real estate (R. 111) and managing the other phases of his soft drink enterprise. (R. 112)

As shown by his tax return for 1953 (R. 174), he received a total of $33,450 in salaries from six different corporations, $27,177 from a partnership, $1,747 from interest, besides his rental income of $12,225. In that year his operation of Cousin's Restaurant resulted in a $3,960 loss (R. 178). He also loaned between $25,000 and $30,-

000 to Angleton Building and Holding Corporation during 1953. (R. 121)

The Court of Appeals for the Sixth Circuit in *Mays v. Commissioner*, 272 F. 2d 788, 60-1 USTC para. 9122, found that the taxpayers were in a business separate and distinct from that of the corporations which they had organized and managed and pointed up the distinction as follows:

> "Mere participation in a corporate venture by owning stock as an investment does not place one in the busines which the corporation carries on. An individual taxpayer is not allowed to override the corporate entity and take unto himself the tax benefit of 23(k)(1) unless the debt bears a proximate relationship to the taxpayer's own true business as distinguished from that of the corporation. *Commissioner v. Stokes' Estate*, 200 F. 2d 637 (C.A. 3) 53-1 USTC 9164. But where a person invests and takes part in their management beyond passively giving financial aid, a bad debt loss to one of the businesses is incident to his regular vocation and is not the result of an isolated investment."

What the court was recognizing in the *Mays* case (supra) as in the *Foss* rule, established years earlier,[9] was that, in order to organize, arrange for and keep in touch with the financing of, coordinate the various activities of, and make the general policy decisions for a group of enterprises, as in the Whipple case varying fro retail lumber yard to a restaurant to various phases of soft drinks enterprise in Lubbock and Amarillo, rental properties, promotion of oil deals, subdivision of real estate in Pasadena, Angleton and Bellaire, construction of houses in different locations,

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[9] **Foss v. Commissioner**, (1 Cir.) 75 F. 2d 326, 35-1 USTC para. 9091.

managing an equipment rental corporation and other activities, would necessarily take such extensive time, thought and efforts of the taxpayer, completely separate from the actual business operations of each of the enterprises themselves, as to constitute a separate business, distinct from that of the corporation themselves.

For the conduct of this overall general mangerial business, Petitioner, A. J. Whipple, received substantial ordinary income in the form of salaries paid by the various corporations, totaling $62,850.00 for the two years, 1952 and 1953. Obviously, little of these salaries could have been for his services in the day to day routine of the various businesses because of the number and variety of such enterprises, the problems of their coordination and financing and their dispersed locations. The availability of much time for involvement in other than the financing and managerial affairs of the corporations is negated by the evidence and, therefore, the salaries must have arisen largely by virtue of his extensive activities separate and distinct from the particular business of the corporations themselves.

This is the basis for the distinction betwen the activities of those who have organized and are managing and financing a number of corporations as in *Campbell*[10], *Macy*[11], *Mays*[12], and *Maytag*[13] cases from those of the financing and managing of a single corporation as in *Ferguson v. Commissioner* (4 Cir.) 253 F. 2d 403, cited by the majority of the Court of Appeals below.

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[10] 11 TC 510.

[11] 8 TCM 45.

[12] (6 Cir.) 272 F. 2d 788, 60-1 USTC para. 9122.

[13] (US Court of Claims) 289 F. 2d 647, 61-1 USTC para. 9424.

The Petitioner organized a wide variety of businesses with a wide variety of people. But in addition to organizing and managing these enterprises, he engaged in extensive activities which go far beyond those of the ordinary organizer.

Petitioner consistently over a period of ten years financed the various partnerships, corporations and joint ventures in which he had an interest through loans he made individually or through a partnership (R. 92; R. 98; R. 100; R. 121).

Petitioner's tax return for 1951 shows interest received from five corporations and three partnerships (R. 29). His return for 1952 shows interest income received from seven corporations and partnerships, as well as seven individuals. (R. 156) In 1953, Petitioner made loans of $25,000 to $30,000 to the Angleton Building and Holding Company. (R. 121) and $52,500 to Mission Orange Bottling Co. of Lubbock, Inc. (R. 63; Exhibit 21-T; R. 183 ff). His income tax returns for the years 1951-1953 reflect interest income of $1,680.15, $2,285.35 and $1,747.59 respectively (R. 29).

Again the Court took a narrow view in holding that Petitioner was not in the separate business of lending money, overlooking this important business function of financing enterprises in connection with his activities of organizing and managing. The Tax Court seems to be saying that because Petitioner collected interest from corporations which he controlled and from persons who worked for these corporations, that this interest should be disregarded. Nevertheless, this interest was collected and was reported as ordinary income. The Tax Court erroneously held, in applying an incorrect legal standard, that he was not in the

business of lending money. No authority for such a ruling was given but the case of *Scott v. Commissioner*, 14 TCM 1029, which is clear authority for just the opposite.[14]

The Tax Court in this case below went on further to deny the loss business bad debt treatment because Petitioner received no interest from Mission Orange and there was no affirmative evidence that it was obligated to pay interest. It is submitted that this is taking a very narrow view of the facts and circumstances of this case. The practice with the other enterprises to which Petitioner loaned money during this three year period is a clear indication that it was understood that interest would be paid, and the law implies the payment of interest *(Art. 5070, Vernon's Annotated Statutes of the State of Texas)*, but Mission Orange simply was unable to pay it. This is the history of such loss cases!

In this regard, too, Petitioner's situation was strikingly like that of the taxpayer in the case of *Scott v. Commissioner*, 14 T.C.M. 1029.[15]

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[14] In that case twelve enterprises were mentioned in the stipulation which the taxpayer, Scott, had been instrumental in organizing. He had loaned money to six. To six he had not. He was sole owner, an officer, or a director of all of them and took an active part in their activities. The court held:

"The loans were business as opposed to non-business bad debts. **Henry E. Sage**, 15 T.C. 299; **Vincent C. Campbell**, 11 T.C. 510; **Maloney v. Spencer**, 172 F. 2d 638."

[15] In the **Scott** case the taxpayer made advances to a corporation which he had organized with two others, as a result of which the corporation owed him $11,430 at the end of 1948. He continued to advance money until April 10, 1950, at which time the corporation owed him $35,568.50 after repayments amounting to $4,100. The court stated in its finding of fact that he had no intentions in the beginning of advancing so much money. No interest was ever paid on the loans. In its holding the court stated:

"Interest was due but was never paid, only because the business was never successful enough to pay it."

Whether or not Petitioner technically fell in the narrow category of being in the business of "lending money" the evidence is clear that he was carrying on extensive activities of financing these corporations and enterprises which, when combined with his other activities of organizing and managing these corporations and partnerships, are in the nature of the conduct of a business rather than those of a passive investor.

In addition to Petitioner's activities in organizing, managing and financing corporations, partnerships and joint ventures, he supplied the very plants and offices out of which all of these operated, and through this activity he generated substantial sums of ordinary income.

As Petitioner, A. J. Whipple, had done years before (R. 93), he bought a location for a lumber company, leased it to Whipple Lumber Company and all the other corporations and partnerships, except those engaged in the soft drink business, operated out of it (R. 103). He formed Whipple Equipment Company which rented trucks and equipment necessary for the conduct of these businesses. (R. 101). In the same manner Petitioner, A. J. Whipple, purchased land, building and plant and leased it to Mission Orange Bottling Co. at $500 per month. (R. 44, R. 28) These activities are analogous to those of the taxpayer in *Maloney v. Spencer,* (9 Cir.) 172 F. 2d 623, 49-1 USTC para. 9176.

Not only, as shown in Point Three, are these rental activities sufficient in themselves to constitute a business[16] to which the bad debt loss was proximately related, but, when taken in conjunction with Petitioner's activities in

[16] **Higgins v. Commissioner,** 312 U.S. 212, 85 L.Ed. 783.

organizing, managing and financing corporations, they make it even clearer that his activities were of a business nature rather than merely those of a passive investor.

In examining the issue of whether or not Petitioner was engaged in the business of carrying on a soft drink enterprise, the court again took an overly restrictive point of view and failed to come to grips with the real issue. The phrase "soft drinks enterprise" is used because we submit that the court's use of the term "bottling business" accounts for the court's very narrow examination.

The record shows that this soft drinks enterprise was started by Petitioner, A. J. Whipple, buying a plant to operate personally. In order to do this he had to qualify personally as a proper person to whom a franchise should be issued. He did qualify and continued from 1951 through 1953 to be the holder of this franchise and personally responsible for the fulfillment of its conditions. (R. 57).

In addition to that, as mentioned before, he built the plant and rented it to the corporation he formed to carry on the bottling phase of the operation itself.

Also, he financed and supplied the money for the operation of the soft drinks enterprise, and many of the trade creditors required his personal guarantee of its operating obligations. (R. 124).

He personally engaged in the soft drinks vending business and organized a soft drinks distributorship (R. 114-115) both different functions of the soft drinks enterprise and separate from the actual bottling of the drinks.

He was, therefore, as a holder of the franchise, a supplier of the building, the credit, and the furnisher of the

financing for the bottling plant, an owner of a vending operation, and an organizer of a distributorship engaged in an over-all soft drinks enterprise. The Mission Orange Bottling Co. of Lubbock, Inc. carried on only the *bottling* phase of this over-all enterprise. The over-all management, the equipping and coordination of these various phases of this soft drinks enterprise, and the handling of its many financing needs constituted business activities separate and apart from the bottling operation carried on by the Mission Orange Bottling Co. of Lubbock, Inc.

As clearly brought out by the testimony of C. L. Barnhardt, District Representative of Mission Dry Corporation, Petitioner, A. J. Whipple, was the over-all manager of the soft drinks enterprise (R. 58), was active in its operation throughout the period from 1951-53 (R. 59) and after August, 1953 was actually the manager of the bottling plant itself. (R. 119)

On December 14, 1953, the Mission Orange Bottling Co. owed Petitioner, A. J. Whipple, $79,389.76 and owed trade creditors approximately, $48,000. (R. 28) On the next day Petitioner Whipple loaned the corporation $48,000 and received as a credit on the account that the corporation owed him, all the bottling equipment in the plant at its book value of $67,332.91 and an automobile for $3,081.75, (R. 78) thus leaving a balance due him of $56,975.10, which became worthless. (R. 74).

When on December 15, 1953, he loaned the bottling corporation $48,000 to pay off trade creditors he was acting to protect the credit of his franchise and over-all operation of this soft drinks enterprise, which showed, as in *Lutz v. Commissioner* (5 Cir.) 282 F. 2d 614, 60-2 USTC para. 9687, that the loan was incurred in his trade or business.

The loss which Petitioner sustained by reason of the debt becoming worthless was proximately related to the business in which he was engaged. Petitioner submits that it was directly related to his soft drink enterprise and, likewise, to his business of organizing, managing and financing and renting to corporations, of which the soft drink enterprise was one facet. The debt was like that in *Macy v. Commissioner*, 8 TCM 45 where the court said:

> "We think that the debts herein were business rather than nonbusiness bad debts because the evidence shows that they had a direct connection with the business carried on by the petitioner and the loss was the result of, and incurred in the petitioner's business of promoting various enterprises and corporations which business was carried on by the petitioner during the years involved and had been carried on by him for many years prior thereto."

Similarly, the Tax Court in *Campbell v. Commissioner*, 11 T.C. 510, expressed the situation when it stated:

> "* * * they were business rather than nonbusiness bad debts because the evidence shows that they had a direct connection with the business carried on by these petitioners and the losses were directly a result of, and incurred in, the business of organizing and operating corporations engaged in the retail coal business, which business of organizing and operating such corporations was carried on by the petitioners during the taxable year."

In the case of *Washburn v. Commissioner* (8 Cir.) 51 F. 2d 949, 2 USTC para. 794, the court clearly stated the issue as: "Was petitioner regularly operating a trade or business?" The case involved Sec. 204(a) of the Revenue Act of

1921, a net operating loss statute, but it is equally applicable to the activities of Petitioner. The following language is particularly pertinent:

> "The statute does not provide that to secure the benefits the taxpayer must be engaged in only one business. It is any 'trade or business'. A party may be engaged in many kinds of business and still be entitled to the benefit of the statute."
>
> "* * * Whether petitioner's business, viewing his entire activities, be regarded as a general one involving active participation in the supervision of the various companies in which he was interested, or whether he be regarded as carrying on a number of separate kinds of business, among which was the development of the timber holdings, the loss in question occurred in a business regularly carried on."

It is apparent from the record that Petitioner was regularly and continuously organizing, financing, renting to and actively managing corporations. He was at all times "more than a passive investor". His activities were "extensive, varied, continuous, and regular. Here is the regularity as distinguished from the isolated or occasional transaction. Here is the frequency and continuity of transactions which give them business status."

These activities were of the type which were reasonably calculated to, and in Petitioner, A. J. Whipple's case did, generate substantial amounts of ordinary income from sources separate and distinct from the conduct of the particular businesses of the corporations themselves. Through all these activities, for the most part carried on separate from the particular business of the corporations themselves, Petitioner generated ordinary income in the years 1952-

1953 in the form of salaries, in the form of rents and in the form of interest in the total amount of $94,658.71. Had his soft drinks enterprise been a success, the income from all three of these sources would have undoubtedly been greater, and, as a result of his efforts to make it so, the $56,975.10 bad debt loss in question resulted.

The Tax Court, applying an incorrect legal standard, as affirmed by the majority of the Court of Appeals for the Fifth Circuit, erroneously failed to hold that Petitioner, A. J. Whipple was engaged in the business of organizing, financing, renting to and managing corporations, partnerships and joint ventures as a proximate result of the conduct of which business the bad debt in question resulted. Such failure is error, requiring this case to be reversed and rendered.

CONCLUSION

Petitioner prays that the judgments of the Tax Court and the Court of Appeals for the Fifth Circuit be reversed and rendered by this Honorable Court.

The case should be reversed because the Courts below applied an incorrect legal standard to the activities of Petitioner, A. J. Whipple, in determining that the $56,975.10 bad debt loss he sustained was not incurred in his "trade or business" as used in Section 23(k)(4) IRC 1939.

This case should be rendered and judgment entered allowing Petitioner a business bad debt deduction in the amount of $56,975.10, as prayed for in Petitioner's Petition for Redetermination of the Deficiency because the

record clearly shows that the $56,975.10 bad debt of Mission Orange Bottling Co. of Lubbock, Inc., was incurred in Petitioner's trade or business within the meaning of Section 23 (k) of the Internal Revenue Code of 1939.

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PROOF OF SERVICE

It is hereby certified that five copies of the above and foregoing Brief of Petitioner were served on Archibald Cox, Solicitor General, Department of Justice, Washington 25, D. C., by depositing the same in the United States Post Office at Houston, Texas, air mail postage prepaid on this ___ day of January, 1963.

_____
Counsel for Petitioners

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INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	4
Argument:	
Taxpayer's losses from the bad debts owed by Mission Orange were not incurred in a trade or business	10
Introduction and summary of argument	10
A. Proof that a bad debt resulted from a transaction for profit is not sufficient to show that the loss was "incurred in the taxpayer's trade or business"	15
B. Organizing, financing and managing one or more corporations is not a separate "trade or business" if the taxpayer's only return is the increased value and earning capacity of his corporate investment	20
1. Investing in the stock of a corporation is not a trade or business	20
2. The contribution of services to a corporation for the purpose of promoting its business and thereby enhancing the value of the taxpayer's investment in its stock is not a trade or business	23
3. The vital distinction between advancing a corporation's business for the purpose of profiting as an investor and carrying on a trade or business is not diminished by the number of corporations in which taxpayer has invested	37

677525—63——1

Argument—Continued

C. The loss from the nonrepayment of the taxpayer's loans to Mission Orange was not incurred in the alleged business of leasing real property, bottling and selling soft drinks, or lending money, nor in any combination of these alleged businesses ..... Page 39

1. The business of leasing real estate 40
2. The business of lending money 45
3. The soft drink business 48
4. Combination of activities 52

Conclusion 53

CITATIONS

Cases:

Alexander v. *Commissioner*, 34 T.C. 758 12
Burnet v. *Clark*, 287 U.S. 410 ..... 21, 24, 27, 38
Campbell v. *Commissioner*, 11 T.C. 510 ..... 12, 38
Commissioner v. *Schaefer*, 240 F. 2d 381 21
Commissioner v. *Smith*, 203 F. 2d 310 ..... 12, 38
Commissioner v. *Stokes' Estate*, 200 F. 2d 637 ..... 12, 21, 23
Coutourie v. *Roensch*, 134 S.W. 413 48
Dalton v. *Bowers*, 287 U.S. 404 ..... 21, 24, 27
Deputy v. *DuPont*, 308 U.S. 488 ..... 20, 21
Dorminey v. *Commissioner*, 26 T.C. 940 31
Foss v. *Commissioner*, 75 F. 2d 326 ..... 12, 21, 23
Giblin v. *Commissioner*, 227 F. 2d 692 ..... 28, 37
Higgins v. *Commissioner*, 312 U.S. 212 ..... 19, 21
Holtz v. *Commissioner*, 256 F. 2d 865 ..... 12, 36, 38
Macy v. *Commissioner*, decided January 18, 1949 (1949 P-H T.C. Memorandum Decisions, par. 49,009) 12
Maloney v. *Spencer*, 172 F. 2d 638 ..... 12, 45
Mays v. *Commissioner*, 272 F. 2d 788 12
Maytag v. *United States*, 289 F. 2d 647 ..... 12, 21, 23, 38
McDaniel v. *Nat. Steam Laundry Co.*, 112 Texas 54 48
McDonald v. *Commissioner*, 323 U.S. 57 34
Noland v. *Commissioner*, 269 F. 2d 108 21
Putnam v. *Commissioner*, 352 U.S. 82 ..... 15, 17
Sage v. *Commissioner*, 15 T.C. 299 ..... 12, 21, 23
Skarda v. *Commissioner*, 250 F. 2d 429 21
Thacher v. *Lowe*, 288 Fed. 994 47

Cases—Continued Page
Towers v. *Commissioner*, 247 F. 2d 233 12
Trepp v. *Commissioner*, 291 F. 2d 669 ..... 12, 27, 30, 34
United States v. *Gilmore*, No. 21, decided February 18, 1963 19
Washburn v. *Commissioner*, 51 F. 2d 949 12
Wheeler v. *Commissioner*, 241 F. 2d 883 12
White v. *United States*, 305 U.S. 281 40

Statutes:
Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):
§ 23 ..... 2, 16, 17
§ 23(a) 16, 19
§ 23(e) 16, 18
§ 23(k) 2, 10, 11, 13, 15, 16, 17, 19
§ 23(l) 16
Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):
§ 162(a) 16
§ 165(c) 16
§ 166 ..... 2, 10
§ 167(a) 16
§ 212 16
Revenue Act of 1921 (42 Stat. 227), § 204(a) 24
Revenue Act of 1924 (43 Stat. 253), § 206(a) 24
Revenue Act of 1942 (56 Stat. 798), § 124 17
Vernon's Texas Civil Statute, Article 5070 47

Miscellaneous:
Ballantine on Corporations 102 (Rev. ed. 1946) 28
1 Dewing, *Financial Policy of Corporations* (5th ed.), p. 416, fn. m 29
H. Rep. No. 2333, 77th Cong., 2d Sess. (1942–2 Cum. Bull. 372) 11, 15, 18, 20
S. Rep. No. 1631, 77th Cong., 2d Sess. 90 (1942–2 Cum. Bull. 504) 11, 18, 20
Treasury Regulations 118 (1939 Code) § 39.23(k)–6 ..... 3, 11
Treasury Regulations on Income Tax (1954 Code), § 1.61–2 30

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 305

A. J. WHIPPLE AND MILDRED WHIPPLE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 24–34) are not officially reported. The opinion of the court of appeals (R. 133–134) is reported at 301 F. 2d 108.

JURISDICTION

The judgment of the court of appeals (R. 144) was entered on April 4, 1962. A petition for rehearing (R. 144–147) was filed on April 24, 1962, and denied (R. 148) on May 11, 1962. The petition for a writ of certiorari was filed on August 7, 1962, and granted (R. 151, 371 U.S. 875) on October 22, 1962. The jurisdiction of this Court rests on 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether taxpayer's activities in organizing, financing, and managing the Mission Orange Bottling Company of Lubbock, Inc., a corporation of which he owned 80% of the stock, constituted—either in themselves or in conjunction with similar activities on behalf of other distinct corporate enterprises—a "trade or business" within the meaning of Section 23(k) (1) and (4) of the 1939 Code, so that his loss from the nonrepayment of loans to the bottling corporation was fully deductible as a "business" bad debt.

2. Whether the loss from the nonrepayment of the taxpayer's loans to the bottling corporation was proximately related to any of his alleged businesses of leasing real property, marketing soft drinks, or lending money, or to any of these in combination.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.[1]
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (k) [as amended by Sec. 124(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Bad Debts.*—
>
> (1) *General rule.*—Debts which become worthless within the taxable year; * * *. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection. * * *

[1] Section 166 (a) and (d) of the 1954 Code is to the same effect.

* * * * *

(4) *Non-business debts.*—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

Treasury Regulations 118 (1939 Code):

SEC. 39.23(k)–6. *Nonbusiness bad debts.* (a) * * * The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case. The determination of this question is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23(e) is "incurred in trade or business" under section 23(e)(1).

(b) The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one

in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a nonbusiness debt for the purposes of this section.

* * * * *

STATEMENT

A. J. Whipple ("taxpayer") and Mildred Whipple[2] are husband and wife and reside in Houston, Texas (R. 25).

1. In April 1951, taxpayer purchased the assets of the Mission Orange Bottling Company, a sole proprietorship owned by one D. C. Casey; rented (as lessee), for a period of 20 months, the premises occupied by Casey's business; and obtained a franchise from the Mission Dry Corporation entitling him to produce, bottle, distribute, and sell Mission beverages in certain counties in Texas. He conducted the business as a sole proprietorship until approximately July 1, 1951. On that date, in order to avoid personal liability in connection with the beverage he was selling to the public, taxpayer transferred the bottling machinery and equipment to Mission Orange Bottling Company of Lubbock, Inc. (hereafter called "Mission Orange"), a corporation he had organized a month earlier. Taxpayer retained the bottling franchise in his own name (R. 27).

Mission Orange was incorporated on June 8, 1951, with an authorized capital stock of $20,000, and issued

[2] Mildred Whipple is joined herein as petitioner because she filed a joint income tax return with her husband for the year 1953. The transactions involved, however, were conducted solely by the taxpayer, A. J. Whipple.

and outstanding stock of $10,000, of which $8,800 was owned by taxpayer (R. 27). The charter of the corporation was amended on December 8, 1952, to increase the authorized and outstanding stock to $40,000, and thereafter the holdings were as follows:

Shareholder	*Shares*	*Percent*	*Par Value*
Taxpayer	308	77.	$30,800
James A. Finley	10	2.5	1,000
Charles Dillingham	2	.5	200
Cecil Clark	20	5.	2,000
Dora B. Ellzey	10	2.5	1,000
D. M. Dozier	10	2.5	1,000
Jack Knostman	20	5.	2,000
James F. Webster	20	5.	2,000
Total	400	100	$40,000

Prior to the end of 1953, taxpayer increased his holding to 318 shares, giving him an equity of $31,800, or 79.5% of the total outstanding stock (R. 28).

Early in 1952, taxpayer constructed a bottling plant on land which he had purchased in Lubbock, Texas. The land was acquired at a cost of $4,589.75, and the plant building constructed at a cost of $39,011.95, for a combined cost of $43,601.70 (R. 28, 44). On July 14, 1952, he leased the plant to Mission Orange for a ten-year term, beginning August 1, 1952, with an option to renew. The prescribed rental was $500 per month over the life of the lease plus one percent of the gross sales of the corporation commencing in the fourth year. In his 1952 and 1953 tax returns, taxpayer claimed a deduction for depreciation of the bottling plant in Lubbock, but reported no rental income from that building in either year (R. 28).

677525—63——2

Throughout the period involved here, taxpayer was president of the corporation, made important policy decisions, and prescribed the business practices to be followed (R. 57, 117–119). During much of 1953 he also performed the function of plant manager (R. 119). His tax returns for the years 1951 through 1953, however, reflect that he received no salary from the corporation.

In purchasing the bottling assets of taxpayer's sole proprietorship, Mission Orange recorded an account payable to him in the amount of $25,502.50 (R. 28). Taxpayer (directly or indirectly) made cash advances to the corporation of $48,550.70 in 1952 and $6,750 in 1953, or a total of $55,300. He also paid expenses of the corporation amounting to $2,975.76 in the years 1951 through 1953, and received refunds and credits of $4,388.50. Thus, the balance due taxpayer on December 1, 1953, was $79,489.76 (R. 28). On December 15, 1953, taxpayer advanced Mission Orange $48,000 to discharge its obligations to trade creditors (R. 28). On the same date he received a transfer from the corporation of all its bottling equipment, machinery, and an automobile, crediting the corporation with their aggregate book value of $70,414.66 (R. 28). On December 31, 1953, the net amount owed to taxpayer by Mission Orange was $56,975.10.

On September 1, 1951, taxpayer acquired 76% of the stock of a corporation known as Mason Root Beer, a soft drink distributing company which bottled root beer in the Lubbock plant and distributed it, pursuant to a franchise, in Amarillo, Texas. Mason Root Beer failed in 1953, and taxpayer's return for that year reflected a $3,300 loss on his stock in that corporation and a non-business debt loss of $53.33 (R. 28, 112–113).

Taxpayer also had a vending-machine arrangement with Ideal, Indiana, which sold vending machines to the trade. Mission Orange had no interest in this venture (R. 28, 114).

2. During the period in question, and for many years previously, taxpayer engaged in a variety of economic activities, chiefly in the construction and real estate fields. Prior to 1941, he was a construction superintendent and an estimator for a lumber company. In 1941, and for approximately one year thereafter, he and an associate were partners in the construction of houses (R. 25). Beginning in 1942, taxpayer helped to form a number of partnerships engaged in various aspects of the construction and building supply businesses (R. 25). In 1949 and 1950, he organized or helped to organize seven corporations, of which six were construction, lumber, or road-building enterprises, and the seventh a real es-

tate rental company which owned and rented the premises occupied by two of taxpayer's other concerns (R. 25–26). In 1951, taxpayer sold his interest in all of these ventures to his partner, Miles Strickland, along with his equity in five other corporations in the rental housing or construction businesses. All of these sales resulted in gain to the taxpayer, which he reported as long-term capital gain in his 1951 income tax return (R. 26).

In 1951, taxpayer purchased improved land in Houston, Texas, to serve as the location for various construction businesses and other enterprises, and also formed a partnership—the A. J. Whipple Construction Company—with three associates (R. 26). During 1951 and 1952, taxpayer was an original incorporator of eight corporations, all but one of which were engaged in various aspects of the construction and real estate development businesses (R. 26). The one exception was Mission Orange.

During the period 1951–1953, the taxpayer acquired land in Pasadena, Angleton, Bellaire, and Houston, Texas, and engaged in sales activities in connection with those properties; purchased, operated, and later sold a restaurant in Houston (R. 26, 95, 104–105); and engaged in several oil ventures (R. 26, 65). Throughout this three-year period, taxpayer made loans to his various corporations, partnerships, fellow shareholders, and partners, some but not all of which yielded him interest. His income tax returns for

1951, 1952, and 1953 reflected the following interest income (R. 29):

Payor	*1951*	*1952*	*1953*
Whipple Lumber Co., Inc.	$19.35	$868.51	$1,047.38
Dozier-Whipple Construction Corp.	61.42	393.89	----------
Whipple Construction Co., Inc.	130.68	5.61	----------
Angleton Homes Corp.	331.98	----------	----------
A. J. Whipple Construction Co.	4.92	44.28	----------
Cecil Clark	70.56	45.61	----------
D. M. Dozier	70.56	45.61	----------
G. A. Durham	86.98	74.33	----------
J. A. Finley	64.46	----------	----------
Whipple Equipment Co., Inc.	591.89	575.51	37.82
Willard Evans	70.56	45.61	----------
Dora Eilzey	70.56	45.61	----------
L. R. Olive	24.99	4.76	----------
Durham-Clark Building Supply Co.	9.24	57.95	----------
W. N. Atkins	20.81	*(20.81)	----------
Roy J. Pafe	1.19	*(1.19)	----------
Harland Miller	----------	47.00	----------
The Brag Club, Inc.	----------	53.07	19.16
Guy Francis-Guy's Restaurant	----------	----------	643.23
Total Interest Income	**$1,680.15	$2,285.35	$1,747.59

*Interest accrued and upaid in 1951.

**The correct total is $1,690.15.

Taxpayer received salaries totalling $29,400 in 1952 and $33,450 in 1953 from some of the construction companies (R. 26).

3. In his 1953 income tax return taxpayer claimed $56,975.10, the amount due him from Mission Orange,

as a business bad-debt deduction (R. 28, 29). The Commissioner determined that this item was a non-business bad debt within the meaning of Section 23(k) of the Internal Revenue Code of 1939 and, on that basis, asserted a deficiency. This determination was affirmed by the Tax Court, which found or concluded, among other things, that taxpayer was not in 1953 in the business of organizing, promoting, managing or financing corporations; of lending money; or, as an individual, of bottling soft drinks (R. 29, 32–33). The Tax Court's decision was affirmed by the court of appeals (R. 133–143).

ARGUMENT

TAXPAYER'S LOSSES FROM THE BAD DEBTS OWED BY MISSION ORANGE WERE NOT INCURRED IN A TRADE OR BUSINESS

INTRODUCTION AND SUMMARY OF ARGUMENT

The principal issue in this case is whether a taxpayer who organizes, manages, and finances a number of corporations, but seeks no financial rewards from these activities other than the benefits which inure to him as a stockholder, can properly claim that he as an individual is in a "business" separate and distinct from the businesses of the corporations. The question is significant because of the distinction which is drawn in Section 23(k) of the 1939 Code (Section 166 of the 1954 Code) between "non-business" bad debts, which are treated as short-term capital losses (*i.e.*, can be offset only against capital gains, plus ordinary income to the extent of $1,000) and other bad debts, which are deductible from ordinary income. Section

23(k)(4) defines a "non-business debt" as—

> a debt . . . other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

The applicable regulation (Treasury Regulations 118 (1939 Code) Section 39.23(k)-6), adopting the language of the committee reports on Section 23(k)(4),[3] requires the relation between the conduct of the trade or business and the loss from the bad debt to be "proximate." To qualify a debt for an ordinary deduction, therefore, the taxpayer must establish (1) that he is engaged in a business, and (2) that the bad-debt loss was proximately related to that business. But when a stockholder sustains a bad-debt loss in connection with a loan to his corporation and seeks to deduct it as a loss incurred in his own trade or business, he encounters the well-established principle that a corporation has a personality separate from that of its stockholders and that *its* business is not *their* business. To escape the impact of this rule, it has become common for taxpayers in that situation to claim as an independent "business," apart from that of a corporation, certain auxiliary activities they perform for the corporation's benefit—*e.g.*, organizing, financing, managing—and to deduct the losses as business bad debts because incurred in connection with that alleged independent business. An irreconcilable conflict has developed among the circuits as to whether

[3] H. Rep. No. 2333, 77th Cong., 2d Sess. 77 (1942-2 Cum. Bull. 372, 431); S. Rep. No. 1631, 77th Cong., 2d Sess. 90 (1942-2 Cum. Bull. 504, 573).

such activities, though their sole purpose is to protect or benefit the taxpayer's investment as a stockholder, nonetheless constitute a "trade or business."[4]

[4] The decision below is solidly supported by *Holiz* v. *Commissioner*, 256 F. 2d 865 (C.A. 9); *Wheeler* v. *Commissioner*, 241 F. 2d 883 (C.A. 2); *Towers* v. *Commissioner*, 247 F. 2d 233 (C.A. 2); *Commissioner* v. *Smith*, 203 F. 2d 310 (C.A. 2), certiorari denied, 346 U.S. 816.

The decisions irreconcilable with the decision below are *Washburn* v. *Commissioner*, 51 F. 2d 949 (C.A. 8); *Foss* v. *Commissioner*, 75 F. 2d 326 (C.A. 1); *Campbell* v. *Commissioner*, 11 T.C. 510; *Sage* v. *Commissioner*, 15 T.C. 299; *Alexander* v. *Commissioner*, 34 T.C. 758; *Macy* v. *Commissioner*, decided January 18, 1949 (1949 P-H T.C. Memorandum Decisions, par. 49,009; *Maytag* v. *United States*, 289 F. 2d 647 (C. Cls.).

Other decisions upon which taxpayer relies are distinguishable. Two cases cited involved alleged businesses having no connection with "organizing, financing and managing" corporations. For instance, in *Maloney* v. *Spencer*, 172 F. 2d 638 (C.A. 9), the court found the taxpayer in the business of leasing real property, which we do not deny can be a business; and the only real issue was the factual question whether the loans were proximately related to the taxpayer's activities in leasing property to his corporations, or to his stockholder interests in those corporations. See *infra*, pp. 40–45. Also, in *Trent* v. *Commissioner*, 291 F. 2d 669 (C.A. 2), the issue was whether a loan made to a corporation by a salaried employee, as a condition to his continued employment, was proximately related to his business of being an employee.

In *Mays* v. *Commissioner*, 272 F. 2d 788 (C.A. 6), the court held that where the taxpayer sets up and uses corporations as a part of a separate, individual business of his own, bad debt losses incurred in so doing are deductible as a business bad debt. We do not quarrel with this principle of law (see fn. 13, *infra*, p. 31), but we believe the fact situation there failed to conform to the requirements of that test.

In *Commissioner* v. *Stokes' Estate*, 200 F. 2d 637 (C.A. 3),

We submit that the court below correctly held that losses sustained by such stockholders from the corporation's failure to repay loans are not incurred in any independent "trade or business" of the stockholder, however active he may be in the corporation's business in an effort to enhance the value of his investment.

In developing our argument we deal first with a preliminary point—Judge Hutcheson's suggestion that section 23(k)(4) allows a full deduction for all bad debts resulting from a transaction for profit—and show that the argument is not only inconsistent with binding precedents but unsound in principle.

We go on to show that a stockholder's receipt of income and capital gains from the ownership of stock in a corporation is not a trade or business, because the corporation's business is not the stockholder's business and the mere receipt of income and capital gains is not a trade or business. For the stockholder to show that he took an active part in promoting and managing the corporation's trade or business adds nothing to his case if his sole return is from his investment in the corporation's business. Moreover, the taxpayer's activities directed solely to enhancing the value and earning capacity of his stock investments do not take on the character of a "trade or business"

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the relation between the corporation and the taxpayer's activities is not clear, and we take no position as to its significance.

merely because he forms and manages several corporations, rather than one.

Finally, we demonstrate the lack of merit in taxpayer's alternative contentions—*i.e.*, that he was engaged in, and incurred the bad-debt loss in the course of one or more of the following separate businesses: (a) lending money; (b) bottling and selling soft drinks; or (c) leasing real property. The Tax Court properly found that the few, relatively small, interest payments received by the taxpayer in the years in question did not warrant the conclusion that he was in the money-lending business, and that even if he had been, there was no evidence that the advances to Mission Orange—which were neither secured nor evidenced in writing, and which provided neither for repayment of principal nor for payment of interest—were made as part of that lending business. The Tax Court further found—again with ample justification—that the taxpayer was not engaged, as an individual, in the "trade or business" of bottling and selling soft drinks at the time the debt in question became worthless. Finally, even if it be conceded that constructing the bottling plant and leasing it to Mission Orange constituted a "trade or business," there is no showing that the bad-debt loss was proximately related to that business. On the contrary, the record shows that the primary, if not the sole, purpose of making the loans was to protect the taxpayer's investment as stockholder, and that his interest as lessor, if it played any part at all in motivating the advances, was entirely secondary.

A. PROOF THAT A BAD DEBT RESULTED FROM A TRANSACTION FOR PROFIT IS NOT SUFFICIENT TO SHOW THAT THE LOSS WAS "INCURRED IN THE TAXPAYER'S TRADE OR BUSINESS"

In the opening pages of his brief (pp. 24–25) the taxpayer seems to imply that the provision for limited deductibility of non-business bad debts (section 23(k)(4) of the 1939 Code) was intended to cover only loans to friends and relatives, made without thought of profit and without expectation of repayment. The same construction appears to have been adopted by Judge Hutcheson in his dissenting opinion below (R. 138–143). Under this view, the entire range of profit-seeking activity would be comprehended within the statutory category of "trade or business." We submit that this interpretation has already been rejected by this Court and, moreover, has no merit as an original matter.

Judge Hutcheson's interpretation was based upon a comment in the House committee report (H. Rep. No. 2333, *supra* at 408) citing personal loans as an "example" of the abuses intended to be curbed by the proposed amendment. He appears to have construed this language to mean that this was the full intended scope of the measure. In *Putnam* v. *Commissioner*, 352 U.S. 82, 90–92, however, this Court rejected without ado a similar contention, saying (p. 91, fn. 17):

> Petitioners argue that this was its sole purpose and that the section should be construed as limited in application to such loans. The context of the segment of the House Ways and Means Committee Report discussing this ob-

jective does not support the petitioners' argument.

And, by way of explanation, the Court set out the same language from the committee report quoted by the taxpayer (Br. 24) and by Judge Hutcheson (R. 140, fn. 2) but with the words "an example" (which precede the reference to loans to a friend or relative) underscored.

Taxpayer's contention, moreover, is fundamentally at odds with both the statutory scheme and the legislative history of Section 23(k)(4). The terminology of the Internal Revenue Code consistently differentiates the broad range of human activities undertaken for profit from the much narrower included category of a "trade or business." Thus, Section 23(e) of the 1939 Code (Section 165(c) of the 1954 Code) allowed a deduction for losses: (1) if incurred in trade or business; and (2) if incurred in any transaction entered into for profit, though not connected with a trade or business. Similarly, Section 23(a) of the 1939 Code (Sections 162(a) and 212 of the 1954 Code) distinguished between (1) trade or business expenses—*i.e.*, all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business; and (2) non-trade or non-business expenses—*i.e.*, all the ordinary and necessary expenses paid or incurred for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income. And, Section 23(l) (Section 167(a) of the 1954 Code) allowed a deduction for depreciation (1) of property used in the trade or business;

and (2) of property held for the production of income. The apposition makes it plain that "trade or business," in these provisions, does not include all transactions for profit.

When Congress used the term "trade or business" in Section 23(k)(4), it presumably intended that term to have the same limited scope it had in the other subdivisions of Section 23 just mentioned. That inference is expressly confirmed by the legislative history of Section 23(k)(4). Prior to 1942, any bad debt loss, regardless of its business or non-business character, was deductible in full from ordinary income. The effect of Section 23(k), which was added to the Code by Section 124 of the Revenue Act of 1942 (56 Stat. 798), was to limit the deductibility of all such losses other than those sustained in the taxpayer's "trade or business." The purpose of the amendment was explained by this Court in *Putnam* v. *Commissioner, supra,* 352 U.S. at 90–92.

> The objectives sought to be achieved by the Congress in providing short-term capital loss treatment for nonbusiness bad debts are also persuasive that section 23(k)(4) applies to a guarantor's nonbusiness debt losses. The section was part of the comprehensive tax program enacted by the Revenue Act of 1942 to increase the national revenue to further the prosecution of the great war in which we were then engaged. It was *also* a means for minimizing the revenue losses attributable to the fraudulent practices of taxpayers who made to relatives and friends gifts disguised as loans. *Equally,* however, the plan was suited to put nonbusiness invest-

> ments in the form of loans on a footing with other nonbusiness investments. * * * We may consider Putnam's case in the light of these revealed purposes. His venture into the publishing field was an investment apart from his law practice. The loss he sustained when his stock became worthless as well as the losses from the worthlessness of the loans he made directly to the corporation would receive capital loss treatment; the 1939 Code so provides as to nonbusiness losses both from worthless stock investments and from loans to a corporation, whether or not the loans are evidenced by a security. * * * [Emphasis added.]

In discussing Section 124, the committee reports state that the determination whether a debt is incurred in a trade or business "is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23(e) is 'incurred in trade or business' under paragraph (1) of that section."[5] Section 23(e), in turn, draws a distinction between losses which are incurred in "trade or business" (paragraph (1)) and losses which are incurred "in any transaction entered into for profit, though not connected with the trade or business" (paragraph (2)). It is plain, therefore, that the category of "non-business" bad debts was intended to include not only personal loans but also loans made in connection with activities which, though profit-seeking, do not constitute a "trade or business" in the technical sense.

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[5] H. Rep. No. 2333, 77th Cong., 2d Sess. 76–77 (1942–2 Cum. Bull. 372, 431); S. Rep. No. 1631, 77th Cong., 2d Sess. 90 (1942–2 Cum. Bull. 504, 573).

The limited scope of the trade-or-business concept is further demonstrated by the legislative history of Section 23(a), which deals, as we have noted, with the deduction of business and non-business expenses. In *Higgins* v. *Commissioner*, 312 U.S. 212, this Court held that the handling and oversight of the taxpayer's extensive stock and bond investments, even though it involved continuous personal activity on the taxpayer's part, as well as the full time operation of an office and staff, did not constitute a "trade or business" for purposes of the business expense deduction. In response to *Higgins*, and as part of the same 1942 legislation which added Section 23(k) to the Code, Congress adopted Section 23(a)(2), authorizing, for the first time, the deduction of "non-trade" or "non-business" expenses, *i.e.*, those incurred in the "production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." See *United States* v. *Gilmore*, No. 21, decided February 18, 1963. It is significant that in making such expenses deductible, Congress did not see fit to broaden the existing concept of trade or business, which had been restrictively interpreted in *Higgins* and which continued to be an important concept for other purposes, but instead created a new category of income-producing activity. Indeed, the committee reports underscore the lack of any intent to alter the trade-or-business concept by pointing out that the amendment would allow deductions "whether or not such expenses are paid or incurred in carrying

on a trade or business."[8] It can scarcely be doubted that when the same Congress, in the same legislation, used the same term—"trade or business"—to define the test of eligibility for business bad-debt treatment, it meant that term to have the same limited meaning it had under the expense-deduction section. And, conversely, it intended that "non-business" bad debts should include income-producing activities of the type covered by the non-business expenses provision.

B. ORGANIZING, FINANCING AND MANAGING ONE OR MORE CORPORATIONS IS NOT A SEPARATE "TRADE OR BUSINESS" IF THE TAXPAYER'S ONLY RETURN IS THE INCREASED VALUE AND EARNING CAPACITY OF HIS CORPORATE INVESTMENT

1. Investing in the stock of a corporation is not a trade or business

The vital distinction between a "trade or business" and other activities which, though not incident to a "trade or business," are nonetheless undertaken for the purpose of profit results in a basic differentiation between "business" activities and "investment" activities. A "trade or business" has been usefully defined by members of this Court as activity which "involves holding one's self out to others as engaged in the selling of goods or services." *Deputy* v. *DuPont*, 308 U.S. 488, 499 (concurring opinion of Justices Frankfurter and Reed.) While there may be room for debate as to whether the element of "holding out" is essential to the concept of business, there can be no doubt as to the essentiality of "selling of goods or services." Broadly conceived, the category of "trade or business" may embrace such diverse enterprises as

[8] S. Rep. No. 1631, *supra* p. 87; H. Rep. No. 2333, *supra*, p. 74, 1942-2 Cum. Bull. 370, 429.

the sale of services by a lawyer or an employee, the sale of a novel, a cartoon, or even an idea; or the "sale" of money at interest. The point we emphasize is that the element of "sale" is an indispensable feature of all of these transactions and the means by which profit is realized.

It is well settled therefore, that the investment of funds in the stock of a corporation or corporations, with a view to deriving gain in the form of dividends and capital appreciation, is not a "trade or business." *Higgins* v. *Commissioner*, *supra*. That rule is expressly conceded by the taxpayer here and by many of the decisions upon which he relies. *E.g.*, *Maytag* v. *United States*, *supra*, at 650; *Commissioner* v. *Stokes' Estate*, *supra*, at 638; *Foss* v. *Commissioner*, *supra*, at 328; *Sage* v. *Commissioner*, *supra*, at 304.

It is equally well-settled that the business of a corporation is not the business of its stockholders for tax purposes. In *Dalton* v. *Bowers*, 287 U.S. 404, and *Burnet* v. *Clark*, 287 U.S. 410, this Court held that when a taxpayer chooses to operate his enterprise through the medium of a corporation, he cannot claim the corporation's business as his own. To the same effect see *Deputy* v. *DuPont*, 308 U.S. 488, 494; *Noland* v. *Commissioner*, 269 F. 2d 108 (C.A. 4); *Skarda* v. *Commissioner*, 250 F. 2d 429 (C.A. 10); *Commissioner* v. *Schaefer*, 240 F. 2d 381, 383 (C.A. 2). This point also is acknowledged here.

From the foregoing propositions it follows that a taxpayer seeking to establish the right to a deduction for a business bad debt on account of a corporation's

failure to repay a loan must show that the loss was incurred in his, the taxpayer's, trade or business. It is not enough that the loan was made to enhance the value and productivity of his stock, and thus to yield a profit. Nor is it enough that the taxpayer was engaged in furthering the corporation's business. To qualify he must prove that the loss was proximately related to a business of his own.

Petitioner seeks to carry this burden by arguing that his activity in organizing, managing, and financing several corporations, of which he was major stockholder and controlling figure, constituted such a business. There is no dispute as to the nature of his activity. Taxpayer was interested primarily in construction, real estate, and related enterprises, occasionally diverging into other fields such as the soft drink operation involved here. Although in earlier years he had conducted these enterprises as partnerships, by 1949 he had begun to operate, for the most part, through the medium of corporations, organizing a new entity for each project and becoming its principal stockholder. His relationship to Mission Orange was typical; he organized it, owned 80% of its stock, occasionally advanced it funds, was its principal officer, and participated extensively in the management of its affairs. Taxpayer contends that these activities were conducted with the frequency, regularity and continuity which, in his view, are the sole criteria of a business.

In support of his position, taxpayer relies upon a series of lower court cases[7] which draw a decisive distinction between the so-called "passive investor," who merely holds stock and cashes dividend checks, and the entrepreneur who organizes and takes an active part in managing several corporations. To the former, these cases would deny business bad-debt treatment; to the latter, they accord it.

We now show that taxpayer's view is unsound and that the cases which support his position should be overruled (see fn. 4, *supra*, p. 12).

2. The contribution of services to a corporation for the purpose of promoting its business and thereby enhancing the value of the taxpayer's investment in its stock is not a trade or business

Organizing, financing and managing one or more corporations does not constitute a "trade or business" of a taxpayer-stockholder if he engages in these activities without compensation, looking for his reward solely to an increase in the value of his corporation's stock. This is the central proposition upon which our case rests. The proposition follows inescapably, we think, from the meaning of "trade or business," which does not include all undertakings for profit, and from the basic distinction between the corporation and its shareholders.

A "trade or business", as we have shown, is a series of more or less regular, loosely grouped transactions

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[7] *E.g., Maytag* v. *United States, supra; Commissioner* v. *Stokes' Estate, supra; Foss* v. *Commissioner, supra; Sage* v. *Commissioner, supra.*

in which the owner of the trade or business exchanges goods or services for some *quid pro quo* in the hope of gain or profit. The element of gain or profit is indispensable, but not all gainful or profitable activity is a trade or business. The element of frequency and regularity is also probably essential, but it too is not enough. There must be present, before there is a trade or business, the additional element of sale or exchange; and the gain or profit must come in the sale or exchange. One who regularly organizes, manages or finances corporations in return for a fee is engaged in a trade or business. And he is so engaged even though he works for only one corporation and receives a salary. In either event the element of a sale or exchange, with its *quid pro quo,* is present. But if the taxpayer renders services in organizing, promoting or managing a corporate business, without receiving any form of consideration, solely for the purpose of building up the corporation's business and thereby profiting as one of its shareholders, he is not engaging in a business of his own and gains a return only as an investor.

This central proposition is established by the classic decisions of this Court in *Dalton* v. *Bowers,* 287 U.S. 404, and *Burnet* v. *Clark,* 287 U.S. 410. Both cases arose under similar provisions in the revenue acts[8] permitting a taxpayer to carry net losses over into a subsequent taxable year as a deduction if the losses resulted from, or were attributable to, "the operation

[8] *Dalton* arose under Section 206(a) of the Revenue Act of 1924, 43 Stat. 253, 260; *Burnet* under Section 204(a) of the Revenue Act of 1921, 42 Stat. 227, 231.

of a trade or business regularly carried on by the taxpayer." In *Dalton*, the taxpayer, an active researcher and inventor, had organized six corporations for the purpose of developing, improving, manufacturing and selling his inventions. He was the sole owner, controller, and manager of each company. When one of these enterprises—to which he had advanced large sums of money—became insolvent, the taxpayer claimed as a loss, attributable to the operation of his own "trade or business", the entire amount he had invested in the then worthless stock of the corporation. He took the position that he, individually, was engaged in the comprehensive enterprise of exploiting his inventions, and that the corporation was merely an instrumentality of that business. Pointing out that the taxpayer was not regularly engaged in the business of buying and selling corporate stocks (but had organized the corporation and taken over its shares with the ultimate intention of selling them at a profit, *i.e.*, presumably, capital gain) and that he had treated the corporation as a separate entity for tax and other purposes, the Court upheld the decision of the court of appeals that the loss was incurred in connection with the taxpayer's investment in the corporation, and not in the operation of a trade or business.

In *Clark*, the taxpayer was the majority stockholder, president, and active head of a dredging company, to which he devoted all of his time and energies. He had also been active in the dredging field through several partnerships which frequently acted in asso-

ciation with the corporation. When the company became insolvent, the taxpayer suffered the loss of his stock investment, and also of amounts paid by him pursuant to his endorsements of the corporation's notes. He claimed the right to a loss carry-over with respect to both types of losses. The court of appeals held for the taxpayer, emphasizing, in a passage quoted by this Court (p. 414), that he was regularly engaged in the dredging business through a corporation to which he devoted his full time and energies and that, while taxpayer admittedly did not regularly carry on the businesses of endorsing notes for profit or selling corporate stocks, his transactions of those types in the record were an integral aspect of the regular course of his dredging business. This Court reversed. It stressed that the business which Clark carried on for the corporation was not his own business; that he had regularly treated the corporation as a separate entity for tax purposes; that he was not regularly engaged in endorsing notes, or buying and selling corporate securities; and that the endorsements were occasional transactions intended to preserve the value of his investment in the capital shares. Although the Court spoke of the endorsements as "occasional transactions," it used the phrase only to point out that Clark was not a money-lender regularly in the business of endorsing notes for profit (just as the taxpayer here was not in the business of lending money for profit).

Thus, the *Dalton* and *Clark* decisions squarely hold that a taxpayer who devotes his time to the business of a corporation, or to the businesses of several corporations, and receives his financial return only as a stock-

holder, is not engaged in an independent trade or business of his own; the business of the corporation is not his business and the obtaining of money as an investor is not a trade or business.

The holding is confirmed by common sense. Suppose, for example, that the sole proprietor of a retail grocery store forms a corporation through which to carry on his enterprise, but continues to direct its affairs on a full time basis and to advance it needed operating funds. Concededly, such a person would no longer, as an individual, be engaged in the grocery business. To be sure, if he received a salary for his services he would then be engaged in the business of being a corporate employee. See *Trent* v. *Commissioner*, 291 F. 2d 669 (C.A. 2); *infra*, pp. 30, 34–35. But, in the absence of compensation, it would border on absurdity to say that the taxpayer, though not engaged in the grocery business, was engaged in the business of managing a corporation engaged in the grocery business. In short, if the present taxpayer's activities are confined to a single corporation, then no matter how extensive and continuous these activities may be; they would not, under *Dalton* and *Clark*, constitute a separate business of "organizing, managing, and financing." Indeed, we are aware of no decision holding that such activities, when undertaken with respect to a single corporation, and with the sole purpose of enhancing the taxpayer's interest as stockholder of that corporation qualify as a "trade or business."

The distinction between such activities and the true "trade or business" of organizing, promoting and managing corporations is clarified by contrasting petition-

er's activities with those of persons who are truly in the "business" of being promoters, organizers or managers of corporations. The true promoter obtains compensation in return for his services in one of two ways:

(i) He may, as a consistent practice, set up corporations with a view to holding them for sale or resale as soon as they achieve going-concern status. In such a case, the corporations would constitute the inventory or stock-in-trade of his individual business of "dealing in corporations," and the proceeds of the sales would have to be reported as ordinary income. In *Giblin* v. *Commissioner*, 227 F. 2d 692, the Fifth Circuit (per Judge Tuttle, who also wrote the court's opinion in the instant case) held that such trafficking in corporations constituted a separate business of the taxpayer.[9]

(ii) He may organize corporations for others in return for a fee or commission. In that case, he becomes a professional "promoter" in the classic sense of that term, the corporate promoter of whom Professor Ballantine wrote the following description:[10]

> The primary function of the promoter is to find an enterprise and interest investors in financing a proposed corporation to take it over. He is the projector who originates the

[9] Whether the facts of *Giblin*—or, for that matter, of any of the decided cases—actually fit that description may, of course, be doubted. The possibility is, indeed, probably more theoretical than real, since the taxpayer who maintains an "inventory" of "corporations" for sale is more readily imagined than found.

[10] *Ballantine on Corporations* 102 (Rev. ed. 1946).

> enterprise of which a corporation is the usual machinery. He is the pre-incorporation developer and manager of the business which the proposed corporation will undertake. The typical promoter,—the promoter in the fullest sense, performs various services in launching an enterprise and may employ experts, lawyers, bankers, solicitors and other persons to aid him. The various activities of the promoter may be classified as follows: (1) the discovery and investigation of a promising business opportunity; (2) the formulation of business and financial plans; (3) assembling the enterprise by negotiations and obtaining some control over the subject matter by options or contracts made on behalf of the proposed corporation or on his own credit; (4) the making of arrangements for financing the enterprise and the flotation of securities; (5) last but not least, he must arrange tactful and painless methods for *getting his own reward for the task of promotion out of the prospective investors* and for reimbursement for his expenses, contracts, and services without frightening away those who are expected to provide the funds. He is thus practically in the position of a seller of the enterprise to the prospective investors, seeking a speculative profit for himself and his associates on the investment of others, very often taken in the form of securities. [Emphasis added.]

The fact that a promoter will often accept all or part of his fee in the form of stock, rather than cash,[11] does

[11] But note that I Dewing, *Financial Policy of Corporations* (5th ed.), p. 416, fn. m, says that "The professional promoter

not alter the nature of his indivdual business as a promoter. It means simply that he has converted his fee into an investment in the corporation, the investment thereafter becoming a separate venture having nothing to do with his promotional business. Whether he receives his fee in the form of cash or stock, he must report it in the year of receipt as ordinary compensation income. If stock is received, it must be treated as the equivalent of cash and reported in the amount of its then fair market value.[12]

In the same way, one might be in the business of "managing" corporations if, instead of being merely an employee of one or more corporations (albeit the managing officer), he were to hold out his services in that capacity as an independent contractor, receiving a fee from his corporate clients. An example might be a hotel management firm which, as an independent contractor, undertook for a prescribed fee the management of a chain of hotels owned by another entity. Indeed, we concede that even a corporate employee, rendering services in return for a salary, would be in a "trade or business." *Trent v. Commissioner*, 291 F. 2d 669 (C.A. 2). And, of course, the specific reward for the service of "financing" corporations would be the receipt of interest or some sort of finder's bonus. The point is, however, that in every case, the services must be given as part of an exchange transaction from which the

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[that is, one who engages in this function as his business] is usually reluctant to accept stock as compensation."

[12] Treasury Regulations on Income Tax (1954 Code), Section 1.61-2.

taxpayer receives a *quid pro quo*.[13] If this element of compensation or *quid pro quo* is removed, then whatever else they may be, the activities do not constitute a business. In such a case, the taxpayer's services to the corporations (or the interest value of the funds he supplies interest-free)[14] constitute simply

[13] Another situation in which business-bad-debt treatment might be warranted arises where the taxpayer sets up a corporation as an instrumentality for carrying out some aspect of his individual business or to protect its operation and earning capacity. An illustration is furnished by *Dorminey* v. *Commissioner*, 26 T.C. 940, in which the taxpayer, who was individually engaged in the produce-selling business, advanced funds to a corporation he had helped organize for the purpose of insuring his produce business a continuing supply of bananas. The losses incurred when the resulting debts became unrecoverable were allowed business-bad-debt treatment because they constituted, in effect, part of the cost of acquiring the goods to be sold by taxpayer's individual produce enterprise. The differences between that situation and the one here are quite obvious: first, the taxpayer in *Dorminey* was undeniably involved in an enterprise which provided its own source of income, separate from that of the corporation; secondly, the purpose of setting up the corporation and lending it money was not to make it a profitable investment to the taxpayer as stockholder (though, presumably, he was not indifferent to the prospect) but, primarily, to make it a dependable supplier of bananas for his produce business. In all bad debt cases in which the taxpayer has a dual stake in the stability of the corporation, so that his interest as stockholder and his interest as seller or buyer go hand in hand, there will, of course, be difficulties of proof as to which interest is uppermost in motivating the loan, see *infra*, pp. 40–45. Whether the taxpayer here may properly claim to be engaged in a separate business in his role as lessor or soft drink entrepreneur is a question we take up *infra*, pp. 48–52.

[14] The question whether the instant advances to Mission Orange constituted a contribution to capital or a true debt is not presented to this Court, since the Commissioner stipulated in the Tax Court that the sole issue with respect to the sums involved here is whether they constitute a business bad debt or a non-business bad debt.

a contribution to capital (which, if the taxpayer is not himself the stockholder, would also be a gift).

Suppose that in the present case taxpayer had organized and managed, without compensation, several corporations, but had held no stock interest in any of them. In that case, it would be quite clear that his activities did not comprise a business, but instead were merely a gift. It is only where a taxpayer is himself the principal holder of the corporate equity that there is even a colorable argument for regarding the services which he performs gratis as a "business"; for here at least the ultimate object of the activities is to benefit the taxpayer, albeit only through the medium of his investment interest in an entity which, in the eyes of the law, is a creature apart from him. The fact is, however, that the stockholder who personally performs services for his corporation without demanding recompense is making a contribution to the capital of the enterprise—a contribution not in money, to be sure, but certainly in money's worth. From the standpoint of the corporation, it makes no difference whether the stockholder receives a fee or salary for his services and then contributes that compensation, or whether he contributes the services themselves.[15] In a real sense, the stockholder's investment of services is at the "risk" of the company's business no less than his investment

[15] Of course, if the taxpayer were actually to earn compensation for his services, he would have to pay a tax on the income; and the corporation would be entitled to an equivalent deduction.

of funds might be, for they will yield him no gain unless the corporation turns a profit. It is clear, we submit, that a course of conduct which amounts, in effect, to no more than a contribution to the successful operation of a corporation in which the taxpayer is a stockholder, and which is intended to benefit him solely by enhancing the value of his investment, cannot be deemed a separate business of his own.

There can be no doubt that the taxpayer's services were of this unrequited character. His income tax returns disclosed that Mission Orange neither paid him nor credited him with a promoter's fee, manager's fee, interest, or even salary during any of the years involved here. Nor does the record show that he received (as an independent contractor) any promoter's or manager's fee from any of the other corporations through which he operated. He did, to be sure, receive a few small interest payments from some of the companies (*supra*, p. 9); but as the court properly found, and as we shall show (*infra*, pp. 45–46), these receipts were not significant enough to place him in the money-lending business or, by the same token, in the business of financing corporations. At no time, moreover, did the taxpayer ever sell corporations as his stock-in-trade, through a transaction in which he received ordinary income. On the contrary, in 1951, when the taxpayer sold a group of 12 corporations, he reported the transactions as the sale of capital assets (R. 31). It is significant, moreover, that in his tax returns for 1952 (Ex. 13–M, R. 157) and 1953 (Ex. 20–T, R. 176)—in Schedule C "Profit (Or Loss) From Business Or Profession"—the taxpayer re-

ported himself as being in only one business, the restaurant business. Yet these two years, and the year preceding them, are at the height of the period in which the taxpayer now claims he was in the business of organizing, financing and managing corporations.

There is only one sense in which any of these auxiliary activities can be said to constitute a "business." Although taxpayer did not receive any salary from Mission Orange, he did receive salaries totaling $29,400 and $33,450 during 1952 and 1953, respectively, from some of the construction corporations (R. 26, 155, 175). In turn, the activity of being a salaried officer or employee of a corporation is a "trade or business" within the meaning of the expense and loss provisions of the Revenue Code. See, *e.g., Trent* v. *Commissioner,* 291 F. 2d 669 (C.A. 2); cf. *McDonald* v. *Commissioner,* 323 U.S. 57, 62 n. 3. However, even acknowledging that taxpayer's services as a salaried employee of Whipple Lumber Co., Inc., Dozier-Whipple Construction Co., or Angleton Construction Company, to mention only three, did qualify as separate businesses of his own, it is clear that his loans to Mission Orange bore no proximate relationship, or indeed any relationship whatever, to those businesses. Moreover, even if taxpayer had received a salary from Mission Orange itself, he would have the burden of showing that the advances which resulted in the bad debt loss were primarily for the purpose of protecting his job, rather than of protecting his investment. *Trent* v. *Commissioner, supra.* In any case, taxpayer did not make the con-

tention, either in the Tax Court or in the court of appeals, that he was in the business of being a salaried employee and that the primary reason for his making the loans was to preserve his job. If there be a hint of such a contention in his brief in this Court (Br. 54), it comes too late.

The distinction we have drawn between the situation in which the taxpayer's activities (organizing, financing, and managing) are devoted solely to achieving the successful operation of the corporation and the situation where these activities have a profit-making purpose of their own was recognized by both courts below and served as a basis for their decisions (R. 31, 137). Thus the crux of the Fifth Circuit's decision is contained in the following passage (R. 136-137):

> We think that the Tax Court was amply warranted in finding that there was no evidence in this record, other than the simple fact that taxpayer had used his talents as a building contractor to organize a large number of companies to conduct such building operations, that he was interested in any way in doing any more than enabling these separate corporations to achieve a successful and lucrative operation as corporations. Taxpayer's claim, it seems clear to us, falls within the class of those who fail to recognize the distinction between carrying on one's business through a corporate form, which of course, requires some organizing and financing, and the business of dealing in corporations, which may likewise require some financing arrangements. As stated by the Court of Appeals

> for the Ninth Circuit in *Holz* [*sic*] v. *Commissioner of Internal Revenue*, 256 F. 2d 865, at page 870: "Where the former is the situation, it is hornbook law, and not contested by petitioner, that the corporate entity is the primary debtor and stockholder loans to protect his investment or increase its value do not create a separate business for the stockholders. As the Fifth Circuit recently said in distinguishing the Giblin case, supra, "Petitioner was not engaged in the business of dealing in enterprises." Pokress v. C.I.R. 1956, 234 F. 2d 146, 150 note 12. Nor did the Tax Court, nor do we, find him so engaged here. The finding of the Tax Court is binding upon us unless clearly erroneous. Here it is not."

Taxpayer reads into the Fifth Circuit's decision a broad holding that one who is active in organizing, managing, and financing corporations cannot obtain a business bad debt deduction unless he shows "that he was a *promoter* who had formed the corporations for the *purpose of selling them.*" (Br. 42, 49–53) (emphasis in original). We submit that the decision imposes no such absolute requirement. The essential test, as we have argued, is whether the taxpayer's organizing and financing activities are intended to provide him a separate source of profit independent of that provided by his investment in the corporation, rather than merely a means of enhancing the profitability of that investment. And, as we have shown, *supra*, pp. 28–30, the taxpayer need not be a "dealer in corporations" in order to satisfy this test. We do not construe the decision below as espousing a narrower view. In singling out a dealership in corporations as an example

of a true promotional business, the court of appeals, we think, was merely attempting to explain and distinguish its previous decision in *Giblin* v. *Commissioner*, 227 F. 2d 692 (C.A. 5), upon which taxpayer had strongly relied, and at the same time to reply to the erroneous contention in the taxpayer's court of appeals brief (p. 10) (a contention he also made in the Tax Court) that he was in the business of "dealing in enterprises."

The force of the principles and precedents discussed above is such that no court, so far as we can discover, has ever held that a taxpayer was engaged in a trade or business because of the time, effort and skill which he put into managing a single corporation in order to profit as the holder of its stock. As we now show, the same principles are controlling even when the taxpayer maintains such a connection with several corporations.

3. The vital distinction between advancing a corporation's business for the purpose of profiting as an investor and carrying on a trade or business is not diminished by the number of corporations in which taxpayer has invested

The basic point we urge in this brief—*i.e.*, that the contribution of services to a corporate business for the purpose of enhancing the value and productivity of the taxpayer's stock is not a trade or business—is equally applicable whether the services are contributed to one or many corporations. The number of corporate entities organized and managed by the taxpayer cannot be determinative of his "business" or "non-business" status. If the continuous, full-time operation and management of one corporation formed by the taxpayer is not an independent trade or busi-

ness, it is difficult to see why similar activity, divided among several such corporations, should change the result. As stated by the Second Circuit in *Commissioner* v. *Smith*, 203 F. 2d 310, 312:

> Respondent's activities in the case at bar were essentially similar to those of the taxpayer in the Clark [*Burnet* v. *Clark, supra*] case, except that respondent here was interested as an investor, manager, and creditor in a number of business enterprises. But since each of these activities separately does not constitute a business, we cannot see how a combination of them spread over various businesses can alter the result. * * *

See also *Holtz* v. *Commissioner, supra*, 256 F. 2d at 869 (C.A. 9). Indeed, whether a taxpayer conducts all phases of his operation through a single large corporation, or, instead, embodies each phase or enterprise in a discrete corporate entity, is largely a matter of choice, the distinct frequently amounting to little more than a matter of bookkeeping.

The present case is a prime illustration, for it appears that all of the corporations formed by the taxpayer here, save only Mission Orange, were operated out of one office (R. 103; Br. 67). If he had combined all his construction-real estate enterprises under a single corporate roof, there would have been little or no difference in the nature or scope of his activities.[16] It would be wholly anomalous to deny

[16] This is undoubtedly true, *e.g.*, of *Maytag* v. *United States, supra*, and *Campbell* v. *Commissioner, supra*.

business bad-debt treatment to a taxpayer who had made loans to the one large corporation through which he conducted his diverse ventures, yet to grant such treatment to another taxpayer, whose activities might have been identical, merely because he had chosen to conduct them through the media of multiple corporations. Since, as we have demonstrated, the decisions of this Court plainly require the denial of business bad debt treatment in the former case, it follows that a similar result should obtain in the latter.

C. THE LOSS FROM THE NONREPAYMENT OF THE TAXPAYER'S LOANS TO MISSION ORANGE WAS NOT INCURRED IN THE ALLEGED BUSINESS OF LEASING REAL PROPERTY, BOTTLING AND SELLING SOFT DRINKS, OR LENDING MONEY, NOR IN ANY COMBINATIONS OF THESE ALLEGED BUSINESSES

The Commissioner's memorandum acquiescing in the petition for certiorari confined itself to the legal issue discussed in Point B, *supra*. Both in the courts below and in this Court, however, as alternatives to the contention dealt with in Point B, taxpayer named several other activities—leasing real property, bottling and selling soft drinks, and lending money—with which he was associated in one capacity or another during the period in which the subject loans were made. He claims that each of these endeavors amounted to a business separate and distinct from Mission Orange, and that the bad-debt loss here was incurred in the course of it. The Tax Court found as a fact (R. 32–33), however, that taxpayer's activities in two of these lines—marketing beverages and lending money—did not rise to the dignity of a "trade

or business." Furthermore, as we will show, the taxpayer wholly failed to prove that the unrepaid loans to Mission Orange were made in connection with any of the three alleged businesses.

1. The business of leasing real estate

Taxpayer maintains (Br. 54–60) that he was personally active in the business of acquiring and leasing real estate, that as part of this activity he constructed and rented to Mission Orange the building it used as its bottling plant, and that the advances to the corporation were made in order to assure the profitability of that lease. Even if it be assumed, however, that the rental of the plant was an incident of the real estate business carried on by the taxpayer as an individual, there is no showing in the record that the bad debt loss was proximately related to that business.

It is hornbook law that a taxpayer claiming the right to a deduction has the burden of proving all elements necessary to qualify him for that deduction. *White* v. *United States,* 305 U.S. 281, 292. Here the taxpayer has fallen far short of meeting that burden. In his testimony below, he never so much as mentioned the lease of the plant as a factor motivating his loans to the corporation. Indeed, the main purport of his testimony was to the contrary, for he asserted that either individually or through a partnership he had made a regular practice of advancing needed funds (chiefly for construction purposes) to the many corporations in which he owned stock, and that his loans to Mission Orange (R. 92, 98–99, 100–

101, 121) reflected this customary practice. Similar allegations appear in his "Statement of the Case" before this Court (Br. 7). It is plain that the evidence of a consistent pattern of contributing operating capital to a variety of corporate enterprises, upon which petitioner places so much emphasis, is at odds with his alternative and unsupported contention that in the case of Mission Orange the purpose of the loans was to protect his position as landlord.

Despite the absence of evidence specifically linking the bad debt loss to the business of leasing the plant, taxpayer urges that since the land and buildings cost him $43,601.70, as compared to the $31,800 he had invested in the stock of the corporation, "it is reasonable to deduce that his advances to Mission Orange Bottling Co. were to a significant degree to help it make his rental business profitable" (Br. 58–59). We need hardly point out that the taxpayer himself was the only person in a position to know whether the loans were prompted "to a significant degree" by the desire to further his interest as lessor, and that inferences and speculations cannot take the place of the straightforward testimony which he was uniquely equipped to provide. But even if this Court were to accept the invitation to "deduce" the purpose of the loans, it would be compelled to the conclusion that "real estate" considerations played little, if any, role in the decision to make the loans.

In the first place, by taxpayer's own reckoning, more than half the advances to the corporation—$69,000 out of a total of nearly $132,000—were made before the bottling plant was even constructed and

during a time when Mission Orange was occupying premises not owned by petitioner (Br. 56). Moreover, approximately $25,000 of this $69,000 represented the unpaid purchase price of the bottling equipment which he transferred to the corporation. To say that these massive loans—a large part of which furnished the corporation with its basic tools—were made in the course of the taxpayer's real estate business is to say that the chief purpose of forming the company was to provide a tenant for the bottling plant petitioner anticipated building—a manifest absurdity. Furthermore, of the roughly $63,000 which the taxpayer loaned the corporation *after* the lease was executed, $48,000 was paid on December 15, 1953, the same day on which the taxpayer, by receiving a transfer of the entire equipment of the corporation, made it impossible for Mission Orange to continue in operation. In our view, this final transaction was not a "loan" at all, but rather a payment in exchange for the equipment. In either case, however, it is quite clear that in making these funds available, taxpayer did not act in his capacity as lessor, since by then it was certain that the tenant would never be in a position either to pay its rent or to repay the debt.

The figures to which we have referred also expose the irrelevance of taxpayer's suggested comparison between the $43,000 outlay for the land and building and the smaller amount which represented his 79% share of the corporate equity. Plainly, the taxpayer's true "investment" in the company as of the date of the lease included not only the cost of the

stock but also the $69,000 which he had contributed in the form of advances and which he could not hope to recoup unless the corporation stopped losing money. Thus, the taxpayer's total investment in the company—taking into account both debt and equity—was more than twice the cost of the real estate. Moreover, whereas the recoverability of the investment in the corporation depended entirely upon the success of Mission Orange itself, there is no showing that the land and building could not have been leased on favorable terms to another tenant, in which case, of course, the additional funds he tied up in Mission Orange would have been available for profitable investment elsewhere. In sum, if the corporation failed, the amount which taxpayer stood to lose in his capacity as investor far surpassed his potential loss as lessor.

By the same token, he stood to gain a great deal more as stockholder than as lessor if the corporation were successful. Under the terms of the ten-year lease, the most the taxpayer could hope to earn from his real estate investment was $6,000 per year, plus one percent of the company's gross sales beginning with the fourth year. It is inconceivable that a landlord who was not also the major stockholder of the tenant would have been prepared to make unsecured, interest-free advances to a risky venture, such as Mission Orange—lending it sums which exceeded by far the investment in the real estate itself—merely for the sake of enabling the tenant to meet its preexisting rental obligation. To be sure, if the corporation had

flourished, the indeterminate component of the rent—one percent of gross sales—might have been substantial. But in that case, the benefits which the taxpayer could expect to derive as stockholder would be many times greater. And, as the record shows, when the corporation failed to earn a profit, taxpayer willingly waived the terms of the lease and demanded no rent at all.

We do not deny that the prospect of collateral benefits in the form of higher and more assured rents may have furnished an added incentive for at least some of the advances. But to establish that a bad debt loss is "incurred in the taxpayer's trade or business," it is not enough to show that the hope of some incidental or derivative business advantage fortified the decision to make the loan. The regulations, echoing the language of the committee reports, *supra*, p. 11, insist that the loss be *proximately* related to the business. To satisfy this condition, we submit, the taxpayer must demonstrate either that the purposes of the business in question were sufficient in themselves to motivate the loan—*i.e.*, that the loan would have been made even if no other considerations had been present—or at least that the business purpose, though not independently sufficient, was the dominant factor. In the present case, neither showing has been made. It is clear that the taxpayer would not have advanced Mission Orange the sums he did—or indeed any sums—if he had merely been the lessor of the plant and not also the stockholder. Conversely, it is nearly certain that he would have made the loans

even if he had been stockholder but not lessor; indeed, as we have pointed out, the lion's share of the advances were actually made prior to the construction of the plant, and while the company was leasing premises from a third party. In any case, however, there can be no doubt that the taxpayer's interest as stockholder was the paramount consideration.[17]

2. The business of lending money

The Tax Court found that the lending activities in which taxpayer was engaged in the years 1951–1953 did not constitute a trade or business, and that even if they had, there was no evidence that the advances to Mission Orange were part of that business (R. 29, 32). This finding, we submit, was clearly supported by the record. The interest payments received by the taxpayer during the period 1951–1953, as reported in his tax returns, amounted to an average of less than $2000 per year, *supra*, p. 9. The major portion of this income was derived from loans to construction corporations and partnerships in which taxpayer had an investment, and the Tax Court quite reasonably concluded that the purpose of these loans was to pro-

[17] Taxpayer's reliance on *Maloney v. Spencer*, 212 F. 2d 638 (C.A. 9), where the taxpayer was held to be in the business of leasing property to three corporations organized and controlled by him, is misplaced. There, the Ninth Circuit found the necessary "proximate" relationship between the taxpayer's bad debt loss and his business as lessor in the fact that the advancement of funds by the taxpayer was explicitly required by the terms of the lease. In the present case, by contrast, the taxpayer's lease neither explicitly nor implicitly imposed such an obligation.

tect that investment rather than to generate proceeds for a separate money-lending business. The remaining interest receipts—averaging only $500 per year—were produced chiefly by loans to the taxpayer's partners and fellow shareholders. It is fair to regard advances of this nature and magnitude as nothing more than accommodation loans, rather than transactions incident to a regular money-lending business. It would appear that the taxpayer made other advances from which he received no interest,[18] but if so, the precise extent and character of this lending is not disclosed by the record. And, with respect to his alleged money-lending operation as a whole, taxpayer offered no evidence bearing upon the manner in which the loans were made; the amount of time and attention devoted by him to this activity; why interest was received in some instances and not in others; whether, in those cases where interest was received, it was paid pursuant to a binding commitment or voluntarily tendered; whether he held himself out as a financier and sought to attract borrowers—all factors of significance in distinguishing active engagement in the business of lending money from the mere practice of making accommodation loans or contributions to capital. The Tax Court's finding, therefore, should not be disturbed.

Moreover, even if the taxpayer had been in the money-lending business in 1953, the loans to Mission

[18] Thus, in 1953, taxpayer advanced $30,000 to Angelton Building and Holding Co. (R. 121), one of his seven construction corporations.

Orange were not made, nor the resulting bad-debt loss incurred, in the course of that business. The corporate obligations here were neither secured nor even evidenced in writing; no provision was made for repayment of the principal or for the payment of interest; and, in fact, no interest was ever paid. As the Tax Court aptly observed, without interest there is no profit, and without profit there is no business. *Thacher* v. *Lowe,* 288 Fed. 994 (S.D.N.Y.). Here, moreover, unless the business could be placed on a going basis, the taxpayer had no reasonable expectation of even recovering his principal. It seems inconceivable that a professional money-lender would consider risking funds under these circumstances unless he were also the major stockholder of the corporation and were acting primarily with a view to furthering his interests in that capacity. The Tax Court was well warranted, therefore, in finding that the instant debt was referrable to the taxpayer's stockholder interest and not to any lending business, assuming he was otherwise engaged in one.

The taxpayer (Br. 71) seeks to supply the missing and essential element of profit-motive by invoking Article 5070 of Vernon's Texas Civil Statute, which provides that:

> When no specified rate of interest is agreed upon by the parties, interest at the rate of six per cent per annum shall be allowed on all written contracts ascertaining the sum payable, from and after the time when the sum is due and payable; and on all open accounts, from the first day of January after the same are made.

Under Texas law, it would appear that that provision is inapplicable to obligations of the type created here.[19] But even if it were assumed that the Texas statute imposed an interest obligation as a matter of law, this still would not establish that the taxpayer's informal advances were the actions of a business money-lender, for it would be extraordinary indeed to find a money-lender who would fail to provide in the customary manner for the profit which is the life blood of his whole enterprise, but would be content to rely upon a statute of doubtful applicability to fix the interest rate for him.

3. The soft drink business

The Tax Court found that taxpayer was not in the soft drink bottling business at the time the debt in question became worthless (R. 32–33). Taxpayer maintains, however, that he was personally engaged in carrying on an "over-all soft drinks enterprise," only one phase of which—the bottling phase—was con-

[19] The taxpayer's advances were not pursuant to any "written contract." Nor (except perhaps for the $25,000 account payable accrued by the company when it bought the taxpayer's bottling assets) were they loans "on open account," as that term has been defined by the Texas courts. Thus, in *McDaniel* v. *Nat. Steam Laundry Co.*, 112 Texas 54, 58, 244 S.W. 135, dealing with an earlier interest provision, it was held that "open account," within the meaning of the Texas statutes, refers only to transactions in which the relationship of debtor and creditor is created by *the sale and purchase of personal property*. In *Coutourie* v. *Roensch*, 134 S.W. 413, 416–417, the court said that "[m]oney advanced under a contract, or at the instance and request of another, does not constitute an open account within the meaning of article 3102, Rev. St. 1895."

ducted by Mission Orange. His individual participation in this "over-all" enterprise allegedly consisted of holding the bottling franchise, owning and leasing to Mission Orange the bottling plant in Lubbock; organizing and owning 76% of the stock in Mason Root Beer, a soft drink distributing company in Amarillo, Texas; jointly owning a soft drink vending machine business; serving as president of and (after August 1, 1953) plant manager of Mission Orange; supplying funds to the corporations; and, after December 15, 1953, owning the machinery and equipment of the bottling company (Br. 73–75; R. 32). Taxpayer explains that the phrase "soft drink enterprise" is used in his brief in contradistinction to "bottling business," the more restrictive term which the Tax Court used and which, according to taxpayer, accounted for the court's unduly "narrow examination." The Tax Court, however, carefully spelled out the argument which taxpayer makes here, recited in his own words all of the activities which he now alleges to constitute a "soft drink enterprise," and only then found against him. There can be no contention, therefore, that the court's finding rested upon a misunderstanding of the taxpayer's position or a failure "to come to grips with the real issue" (Br. 73).

The finding, moreover, was amply warranted. Although for a short time in 1951 the taxpayer was in the bottling business as a sole proprietor, he transferred his assets to Mission Orange on July 1 of that year and thereafter the bottling enterprise was carried

on solely by the corporation. Similarly, it is difficult to see how Mason Root Beer, another soft drink corporation organized and controlled by the taxpayer, can be considered part of a business conducted by him as an individual. But even if the root beer operation had been carried on by the taxpayer himself, rather than by his corporation, there would still be no evidence that it had any connection with Mission Orange (or any of the other activities alleged to constitute the "over-all soft drink enterprise") other than that the product distributed by Mason in Amarillo was also bottled in the Lubbock plant.

The holding of a soft drink franchise is not itself a business activity; it is merely a precondition to entering the business. Whether the holder is *in* the business depends upon the degree to which he actually undertakes the activities which the franchise allows him to undertake, and this must be determined without reference to the holding of the franchise itself. Nor, of course, did taxpayer become a *soft drink* entrepreneur merely by constructing, owning and leasing to Mission Orange a building to be used as a bottling plant.

There remains only one activity which could possibly qualify as a soft drink enterprise carried on by the taxpayer personally—namely, the vending-machine operation set up as a joint venture with Ideal, Indiana (R. 28, 114). But as to the precise nature and location of this enterprise, and the relationship (if any) which it bore to Mission Orange, the record is almost mute, disclosing only that "we hold [sic]

vending machines to the trade." Whether the business was active or dormant; whether the machines were geared exclusively or even primarily to Mission Orange products; whether the bottled products themselves, or only the machines, were sold to the trade;[20] whether the operation was centered in Indiana (as the name of the joint venturer suggests), in Texas, or elsewhere—these and other important questions are entirely unanswered. Two facts, however, are significant. First, the tax returns for the years 1952 and 1953 disclose that taxpayer received no income in that period from the vending-machine "business" or indeed from *any* of the activities alleged to have constituted a separate individually-conducted soft drink enterprise. This consideration alone would seem fatal to the taxpayer's contention. Second, taxpayer has never claimed, and does not now claim, that the purpose of the advances to Mission Orange was to protect the vending-machine business or assure it a continued supply of bottled products. And there would be no evidentiary support for such a claim even if one were made. Under these circumstances, we submit, the brief reference in the record to "a vending machine set up" (R. 114) is not enough,

[20] In his petition in the Tax Court, the taxpayer stated that the vending-machine operation consisted of "selling Mission Orange Bottling products through vending machines as a joint venture on the side with two employees of the corporation" (R. 7). In his actual testimony, however, taxpayer did not state that the bottling products themselves were sold in connection with the vending-machine operation.

either alone or in conjunction with the other factors we have discussed, to establish an "over-all soft drink enterprise" out of which the bad-debt loss arose.

4. Combination of activities.

Having argued that a variety of activities on his part each constituted a business in the course of which the instant loss was suffered, taxpayer makes a scatter-gun claim that the courts below, even if correct in rejecting his contentions as to each individual line of activity, erred in failing to recognize that the combination of these various elements satisfied the statute. In so doing, he merely reiterates the several arguments advanced with respect to the individual claims and fails to show in what way the whole amounts to more than the sum of its parts.

The answer to this contention is apparent from what we have already said. The fact that the taxpayer may have been individually active in a particular business—*i.e.*, construction and real estate—does not transform all his other economic activities—*e.g.*, making accommodation loans—into a trade or business, much less into a single composite business embracing dissimilar and unrelated elements. And even if it did, the fact would still remain that the purpose of the loans and advances which gave rise to the bad-debt loss was not to further the interests of that separate, many-faceted, unincorporated business, but rather to make Mission Orange a successful investment.

CONCLUSION

For the reasons stated above, the judgment of the United States Court of Appeals for the Fifth Circuit should be affirmed.

Respectfully submitted,

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NO. 305

IN THE

Supreme Court of the United States

OCTOBER TERM 1962

A. J. WHIPPLE AND MILDRED WHIPPLE, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

REPLY BRIEF FOR PETITIONERS

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SUBJECT INDEX

	PAGE
TABLE OF CASES	ii
QUESTION PRESENTED	1
POINTS ON REPLY	2
FIRST POINT: The majority of the Court of Appeals for the Fifth Circuit erred in affirming the holding of the Tax Court that the taxpayer in order to deduct as a business bad debt one of many loans made in the course of his extensive activities in organizing, managing and financing numerous corporations, must also prove that he was a person who had formed the corporations for the purpose of selling them.	2
SECOND POINT: The Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to hold that the extensive activities of the taxpayer in organizing, managing, operating, financing, lending, equipping and renting to corporations, partnerships and joint ventures constituted a business to which the $56,975.10 bad debt was proximately related.	2
ARGUMENT	3
FIRST POINT RESTATED	3
SECOND POINT RESTATED	12
CONCLUSION	22
PRAYER	25
PROOF OF SERVICE	26

LIST OF AUTHORITIES

CASES	PAGE
Alexander v. Commissioner, 34 T.C. 758	9
Burnet v. Clark, 287 U.S. 410	14, 15, 16
Campbell v. Commissioner, 11 T.C. 510 (1948) Acq. 1949-1 CB 1	9, 23
Cluett v. Commissioner, 8 T.C. 1178 (1947) Acq. 1947-2 CB	9
Dalton v. Bowers, 287 U.S. 404	14, 15
Fackler v. Commissioner (6 Cir.), 133 F. 2d 509 43-1 U.S. T.C. para. 9270	13
Foss v. Commissioner (1 Cir.), 75 F. 2d 692, 35-1 U.S.T.C. para. 9091	9, 21, 23
Harvey v. Commissioner (9 Cir.), 171 F.2d 952, 49-1 U.S.T.C. para. 9124	13
Higgins v. Commissioner, 312 U.S. 212, 85 L. Ed. 783	25
Holtz v. Commissioner (C.A. 9), 256 F.2d 865, 870 T.C. Memo 1957-106	11
Maloney v. Spencer (9 Cir.), 172 F.2d 638, 49-1 U.S.T.C. para. 9176	9
Mays v. Commissioner (6 Cir.), 272 F.2d 788, 60-1 U.S.T.C. para. 9122	9
Maytag v. U. S. (U. S. Court of Claims), 289 F.2d 647, 61-1 U.S.T.C. para. 9424	9
Putnam v. Commissioner, 352 U.S. 82, 1 L. Ed.2d 144	3, 9
H. Beale Rollins, 32 T.C. 604, aff'd (4 Cir.), 276 F.2d 368, 60-1 U.S.T.C. para. 9357	11
Sage v. Commissioner, 15 T.C. 299 Acq. 1951-1 CB 3	9
Stokes' Estate, Commissioner v. (3 Cir.), 200 F.2d 637, 53-1 U.S.T.C. para. 9164	9
Trent v. Commissioner (2 Cir.), 291 F.2d 699, 61-2 U.S.T.C. para. 9506	9
Vreeland v. Commissioner, 31 T.C. 78	11
Washburn v. Commissioner (8 Cir.), 51 F.2d 949, 2 U.S.T.C. para. 794	9, 13

MISCELLANEOUS	
Ballantine on Corporations 102 (Rev. Ed. 1946)	8
Internal Revenue Code of 1939, Section 23(k)(1)	1, 3, 22
Internal Revenue Code of 1939, Section 23(k)(4)	1, 3, 4, 8, 22, 25
Internal Revenue Code of 1939, Section 117(a)(10(b)	10
Revenue Act of 1942	4
Treasury Regulation 39.23(k)-6(b)	2
U. S. Code Congressional Administrative News 1963, No. 1, Page 43	10

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On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

REPLY BRIEF FOR PETITIONERS

QUESTION PRESENTED

The sole issue in this case is whether the $56,975.10 debt of Mission Orange Bottling Co. of Lubbock, Inc., to Petitioner, A. J. Whipple, was a business bad debt or a non-business bad debt within the meaning of Section 23 (k) (1) or Section 23 (k) (4), respectively, Internal Revenue Code of 1939.

It was stipulated (1) that it was a debt; and (2) that it became worthless in 1953. (R. 56).

This turns on whether or not the loss resulting from the debt's becoming worthless bore a proximate relationship to the conduct of a business in which Petitioner, A. J. Whipple, was engaged at the time it became worthless. T.R. 39.23(k)-6(b).

POINTS ON REPLY

First Point

The majority of the Court of Appeals for the Fifth Circuit erred in affirming the holding of the Tax Court that the taxpayer in order to deduct as a business bad debt one of many loans made in the course of his extensive activities in organizing, managing and financing numerous corporations, must also prove that he was a person who had formed the corporations for the purpose of selling them.

Second Point

The Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to hold that the extensive activities of the taxpayer in organizing, managing, operating, financing, lending, equipping and renting to corporations, partnerships and joint ventures constituted a business to which the $56,975.10 bad debt was proximately related.

ARGUMENT

First Point Restated

The majority of the Court of Appeals for the Fifth Circuit erred in affirming the holding of the Tax Court that the taxpayer in order to deduct as a business bad debt one of many loans made in the course of his extensive activities in organizing, managing and financing numerous corporations, must also prove that he was a person who had formed the corporations for the purpose of selling them.

The real issue presented in this case is whether the activities of Petitioner who engaged in extensive, varied, continuous and regular activities of organizing with many different people, many different corporations, partnerships and joint ventures over a period of years, to carry on many different types of business, in many different localities, and financing, managing and equipping such enterprises for which he received $94,478.71 as ordinary income in the years 1952 and 1953 in the form of salaries, rent and interest, and who incurred a bad debt loss resulting from a loan made to one of those corporations, were business activities or merely investment activities.

If these activities were business in character, the bad debt loss incurred therein would be a business bad debt within Section 23(k)(1) of the Internal Revenue Code of 1939.

In other words as this Honorable Court pointed out in the case of *Putnam v. Commissioner*, 352 U.S. 82; 1 L. Ed. 2d 144, one of the main purposes of the insertion of Sec-

tion 23(k)(4) was to deny the full loss for a bad debt incurred in connection with an *investment*. In commenting on the purposes of the comprehensive tax plan enacted by the Revenue Act in 1942 the court said:

> "Equally, however, the plan was suited to put non-business *investments* in the form of loans on a footing with other non-business *investments* * * * We may consider Putnam's case in the light of these revealed purposes. His venture into the publishing field was an *investment* apart from his law practice." (Empnasis supplied).

The Respondent states his position on page 23 of his brief as follows:

> "Organizing, financing and managing one or more corporations does not constitute a 'trade or business' of a taxpayer-stockholder if he engages in these activities without compensation, *looking for his reward solely to an increase in the value of his corporation's stock*. This is the central proposition upon which our case rests." (Emphasis supplied).

Without quarreling with the rule advanced by Respondent, it certainly is not applicable to the facts in this case. Rather than "looking for his reward solely to an increase in the value of his corporation's stock", Petitioner, Whipple, received his "reward" in the form of salaries, interest and rents. Petitioner organized, financed and managed numerous corporations, partnerships and joint ventures, looking for his reward not from an increase in the value of his stockholdings but from ordinary income received from entities he created to avail themselves of his services and pay him salaries for his managerial and organizational

services, pay him interest on the money he loaned to them, and pay him rent for buildings which he leased to them.

It was these goals as distinguished from an intent to increase the value of his investments that occasioned his receipt in 1952 and 1953 of $94,478.71 in salaries, interest and rents and $56,376.28 as partnership income.

Respondent consistently emphasizes that there must be a sale or exchange for there to be a business. That element of business was not ignored in Petitioner's situation or in his course of conduct. Petitioner performed services for the various enterprises with which he dealt. To some that service was the organization or creation of the entity so that it might engage in a business of its own. To others, or those same entities, he performed the service of obtaining financing for them. To some he loaned money. To still others, and again some of the same, he performed managerial services. He also provided them the buildings out of which to operate. Most frequently, these services were performed in concert. The commodity which he sold was not an inventory of corporations but himself, the use of his money and the talents which he possessed in those fields. Most of the enterprises were able to compensate him for that commodity but, unfortunately, Mission Orange was not. The fact that no compensation was paid does not show that the service was not performed or that the business did not exist. Every merchant is familiar with the customer to whom goods are sold or for whom services are performed but who fails to pay for them. If no payment is received, does the sale or service evaporate or the merchant's business disappear? Certainly not. By the same token, Petitioner's services were real and beneficial and the debt

owed him by Mission Orange was an integral part of his business.

A realization on the value of an investment can come about in only one of two ways. It may come in dividends or by the sale of the investment. Contrasted with the $94,478.71 received by Petitioner from rent, interest and salaries the Petitioner received only $3,300 from dividends in the years 1952-1953 (R. 154; 175), and the Tax Court correctly found that he did not form the corporations for sale. (Tr. 31). Therefore, the rule sought by the Respondent simply has, and can have, no applicability to the case before this Court.

Having stated a rule that does not apply to Petitioner, Respondent in his brief then goes on to give two illustrations of persons who would qualify for bad debt treatment under his theory, but who do not resemble Petitioner. He thus implies that because Petitioner is not one of such type of persons, he, therefore, does not qualify for business bad debt treatment.

The two types mentioned both fall under the category of promoters. The Respondent asserts that (Br. 28):

> "The true promoter obtains compensation in return for his services in one of two ways:
>
> '"(i) He may, as a consistent practice, set up corporations with a view to *holding them for sale or resale* as soon as they achieve going-concern status. In such a case, the corporations would constitute the inventory or stock-in-trade of his individual business of 'dealing in corporations', and the proceeds of the sales would have to be reported as ordinary income. In Giblin v. Commissioner, 227 F. 2d 692, the Fifth

> Circuit (per Judge Tuttle, who also wrote the court's opinion in the instant case) held that such trafficking in corporations constituted a separate business of the taxpayer." (Emphasis supplied).

It was the narrow limitation of the allowance of the business bad debt deduction to the type of person who, as the Tax Court put it, is "in the business of dealing in corporations" (R. 31), or, as the Court of Civil Appeals describes it, is in "the business of dealing in enterprises" (R. 136), one who is "regularly engaged in the business of seeking out business opportunities, promoting, organizing, and financing them, contributing to them substantially 50% of his time and energy and then *disposing of them at a profit or loss*" (R. 136), which is the cause of the error committed by the courts below. (Emphasis supplied).

As pointed out in Petitioner's original brief at page 52, the fact the Petitioner never held an inventory of corporations for sale is demonstrated by his treatment as capital gain, rather than ordinary income, the proceeds of the liquidation at book value of his minority interests in corporations and partnerships he owned with Strickland. (R. 94)

Respondent admits that the requirement made by the courts below that the corporations must be held for sale is entirely unrealistic by saying in footnote 9 on page 28 of his brief:

> "9. Whether the facts of Giblin—or, for that matter, of any of the decided cases—actually fit that description may, of course, be doubted. The possibility is, indeed, probably more theoretical than real, since the

taxpayer who maintains an 'inventory' of 'corporations' for sale is more readily imagined than found."

Being faced with that enigma, he adds a corollary that a true promoter may also "organize corporations for others in return for a fee or commission" (Br. 28). Actually, as a practical matter, this broadening of the meaning of "dealer in enterprises" to include the promoter who collects a fee would bring very few, if any, more cases under the business bad debt deduction provisions of Section 23(k) since this type of promoter, after helping to organize a corporation, usually simply collects his fee and moves on to promoting another. Therefore, he would have no part in managing the corporation. In those cases where, in the words of Respondent's brief (Br. 30), "he has converted his fee into an investment in the corporation, the *investment thereafter being a separate venture having nothing to do with his promotional business*," there would be no justification under the narrow rule applied by the courts below for allowing him business bad debt deduction even if, in fact, he did manage the corporation. (Emphasis supplied). Furthermore, the real promoter would never be financing the corporation. If he had the funds to do so, he would not have to promote ventures. In the words of Professor Ballantine, quoted by Respondent (Br. 28), "The primary function of the promoter is to find an enterprise and *interest investors in financing* a proposed corporation to take over." (Emphasis supplied).

Thus, the application of the rule applied by the courts below amounts to a decision that Congress, by the insertion of Section 23(k)(4) into the Internal Revenue Code back in 1942, really intended to preclude the deduc-

tion as a business bad debt of any loan to a corporation in which the taxpayer is interested.[1]

Such an extreme result is not only illogical but goes squarely in the teeth of equity, sound public policy, Treasury rulings,[2] the intent of Congress,[3] good tax law, and the long established rule of the cases.[4]

Where continuous and regular activity produces income which is taxed as ordinary income, losses occasioned by such activity should be treated as ordinary loss.

Taxpayers engaging in what has been considered for years as business activities, who have been taxed on ordinary income as a result of such activities and who take

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[1] This was pointed out by Judge Hutcheson in his dissent as follows (R. 143):

> "It seems to me that the basic fault of the majority opinion is holding, as it in effect does, that business bad debt treatment must be denied the taxpayer here because the loan was to a corporation in which he was interested. This holding is, in my opinion, a clear addition to the taxing statute. If Congress had so intended, it could and would have so provided. Not having done so, neither the Tax Court nor this Court can construe the statute as though it contained such provision."

[2] **Cluett v. Commissioner,** 8 T.C. 1178 (1947) Acq. 1947-2 C.B. 2; **Campbell v. Commissioner,** 11 T.C. 510 (1948) Acq. 1949-1 C.B. 1; **Sage v. Commissioner,** 15 T.C. 299, Acq. 1951-1 C.B. 3.

[3] See **Putnam v. Commissioner,** 352 U.S. 82, 1 L. Ed. 2d 144.

[4] **Campbell v. Commissioner,** 11 T.C. 510; **Mays v. Commissioner** (6 Cir.), 272 F. 2d 788, 60-1 U.S.T.C. para. 9122; **Maloney v. Spencer** (9 Cir.), 172 F. 2d 638, 49-1 U.S.T.C. para. 9176; **Commissioner v. Stokes' Estate** (3 Cir.), 200 F. 2d 637, 53-1 U.S.T.C. para. 9164; **Sage v. Commissioner,** 14 T.C.M. 1029; **Alexander v. Commissioner,** 34 T.C. 758; **Trent v. Commissioner** (2 Cir.), 291 F. 2d 699, 61-2 U.S.T.C. para. 9506; **Maytag v. U. S.** (U. S. Court of Claims), 289 F. 2d 647, 61-1 U.S.T.C. para. 9424; **Foss v. Commissioner** (1 Cir.), 75 F. 2d 692, 35-1 U.S.T.C. para. 9091; and see also **Washburn v. Commissioner** (8 Cir.), 51 F. 2d 949, 2 U.S.T.C. para 794.

the risk of assuming the same tax treatment for losses, should not be suddenly caught in a radical departure from the established rule, such as was done by the courts below and is urged by the Respondent.

While taxing statutes cannot be given the durability of a rule of property because to do so would deprive the legislative body of the power to meet changing economic needs, the tax laws should not be suddenly changed by judicial construction, as was done by the lower courts.

As we have shown, the rule sought by the Respondent would apply only to the rare, if not purely theoretical type of promoter who holds an inventory of corporations for sale. This is the promoter who initiates an enterprise, makes someone else pay him for it, drops it and goes on to another, to get ordinary loss treatment. On the other hand, under such a rule, the small businessman who not only initiates the enterprises, but who goes on to finance and manage them and pays tax, year after year, on the ordinary income he has generated in the process, would be forced, when he sustains a loss, to have his tax deduction virtually eliminated. Although ordinary income is taxable in full, the holding of a debt to be a non-business bad debt may result in a taxpayer's being able to deduct only $1,000 of it if he has no capital gains against which to offset it.[5]

Recently the President recommended a bill to Congress giving tax relief to stimulate business.[6] It is hard to think

[5] Section 117(a)(10)(B) IRC 1939 "OTHER TAXPAYERS—In the case of a taxpayer other than a corporation, the term 'net capital gain' means the excess of the losses from sales or exchanges of capital assets, plus net income of the taxpayer or $1,000, whichever is smaller, over the losses from such sales or exchanges.

[6] U. S. Code Congressional And Administrative News, 1963, No. 1, page 43.

of anything that could do more to discourage enterprising small businessmen, such as Mr. Whipple, than to allow the theory applied by the lower courts to become the law. It could discourage them from organizing new enterprises, from creating new jobs, from stimulating more spending and generating more taxable income to fight against the threat of recession and to stimulate national growth.

Respondent, recognizing that the holding of the courts below cannot meet the test of either logic or practicality, in an effort to bolster such decisions tries to broaden the meaning of the rule laid down.

For the reasons set forth in detail in Petitioner's brief (Br. 45-49) Petitioner readily confesses that he is considerably confused, as must be other taxpayers, and, as the cases show, have been several courts[7] as to what rule is followed in the Fifth Circuit, but we submit that very convincing evidence of the rule that was applied to *this* taxpayer in *this* case comes from Judge Hutcheson who sat in on the deliberations and the decision in the case, when he stated:

> "The taxpayer in the Cluett case was certainly not in the business of selling stock exchange seats, and Mr. Campbell was not in the business of selling coal companies. Yet the government contends, and the tax court and the majority have erroneously held, that in order for the loss to be deductible, taxpayer Whipple must show that the numerous corporate enterprises which he promoted, financed, and managed were formed by him for sale. This extension of the re-

[7] **Holtz v. Commissioner** (C.A. 9), 256 F.2d 865, 870, T.C. Memo 1957-106. **H. Beale Rollins,** 32 T.C. 604, aff'd (4th Cir.) 276 F.2d 368, 60-1 U.S.T.C. para. 9357; **Vreeland v. Commissioner,** 31 T.C. 78.

striction on the qualification of business bad debts contended for by commissioner and tax court considerably restricts the remedy which congress provided for curing the mischief it had in mind. I think it clear that such restriction was never contemplated by Congress. Indeed the contention pressed here emasculates a clearly intended remedial law."

Second Point Restated

The Court of Appeals for the Fifth Circuit and the Tax Court erred in failing to hold that the extensive activities of the taxpayer in organizing, managing, operating, financing, lending, equipping and renting to corporations, partnerships and joint ventures constituted a business to which the $56,975.10 bad debt was proximately related.

The Tax Court and the majority of the Court of Appeals held that Petitioner was not entitled to a business bad debt deduction unless he could show (1) that he was a dealer in corporations having organized them for sale; or (2) that he was in the recognized business of lending money; or (3) that he was in the business of actually bottling soft drinks.

The courts below failed to make any finding with regard to Petitioner's assertion that his activities, when considered in combination, constituted a separate and distinct business to which the $56,975.10 bad debt loss was proximately related. The courts below apparently failed to recognize the distinction between mere investment activities and actual business activities, which, although not stereotyped, existed and were evident.

The dissenting judge in the Court of Appeals grasped the import of Petitioner's argument and the significance of his course of conduct when he wrote (R. 138):

> "The taxpayer is here insisting that the tax court below and the government in its brief and on oral argument have failed to recognize, and give effect to the fact that, though taxpayer's activities which gave the debt rise might not lend themselves to a specific name or label, they were certainly of a business nature within the meaning and intent of the act, in that the petitioner engaged in them for the purpose of deriving income therefrom, and the bad debt loss suffered had a direct relationship to the conduct of these business activities."

Also, it was the failure to take into account that a taxpayer may be in more than one business that caused the Courts below to err.[1]

Petitioner sought his "reward", not from an enhancement in the value of any single stockholding, but rather in the form of salaries, interest and rents as a result of his complex activities in connection with the broad scope of his undertakings in organizing, financing, managing and leasing to corporations. His activities included the interesting of other people in his enterprises as well as himself.[2]

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[1] See **Harvey v. Commissioner** (9 Cir.), 171 F. 2d 952, 49-1 U.S.T.C. para. 9124; **Fackler v. Commissioner** (6 Cir.), 133 F. 2d 509, 43-1 U.S.T.C. para. 9270; and also **Washburn v. Commissioner** (8 Cir.), 51 F. 2d 949, 2 U.S.T.C. para. 794, where the court said:

> "The statute does not provide that to secure the benefits the taxpayer must be engaged in only one business. It is any 'trade or business'. A party may be engaged in many kinds of business and still be entitled to the benefit of the statute."

[2] W. E. Brown (R. 85); Miles Strickland and W. C. Perkins (R. 85); Bentley Strickland (R. 88); George Lesti (R. 88); John W. Anderson

The Respondent places great reliance in his brief on *Dalton v. Bowers*, 287 U.S. 404, and *Burnet v. Clark*, 287 U.S. 410, but neither has any application to the facts in this case.

In the *Dalton* case, the question of whether a taxpayer should be allowed a full loss on debts the corporation owed him was not before the Court. Apparently, the bad debt losses had been allowed in full for loans to the corporation under the then existing law. The question was whether the loss on stock which had become worthless in 1924 could be carried forward to 1925 as a loss attributable to the operation of a trade or business. The Court stated:

> "He testified that his primary purpose in this venture was to perfect his sundry models and patented articles and *sell the corporation shares profitably;* he thought it would be better to market such articles through the corporation, to have the business in corporate form; he considered the *corporation as a branch or part of his own business* as an inventor and dealer in patents, etc.—as a means to an end; an instrumentality of his purpose. * * *" (Emphasis supplied).

In denying Dalton's assertion that the corporation was a part of his individual business, this court quoted from the opinion of the Circuit Court of Appeals as follows:

> "There is no justification for saying that the business of the corporation was that of the Appellee * * *"

(R. 90); V. L. Yarborough, L. R. Olive, G. A. Durham (R. 100); D. M. Dozier (R. 100); Bill McKinney (R. 106); James Finley (R. 45), Cecil Clark (R. 45); Dora B. Ellzey (R. 45); Jack Knostman (R. 45); James F. Webster (R. 45), Head (R. 65).

> "* * * The loss now sought to be deducted was an investment which he made in the corporation and did not occur in the operation of a trade or business *regularly carried* on by the appellee * * *."
>
> "By the statute allowing the deductions and carrying over the loss for two years Congress intended to give relief to persons engaged in an established business for losses incurred during a year or depression in order to equalize taxation in the two succeeding and more profitable years. It was not intended to apply to *occasional or isolated* losses." (Emphasis supplied)

It is significant to notice also that the petitioner in the *Dalton* case was the sole stockholder. There was no indication whatever of any activities in interesting other people to invest and take part in different enterprises.

The distinction between *Dalton* and this Petitioner is that Dalton sought to establish an identity between his own business and that of the corporation. On the other hand, Petitioner's activities were organizing, financing and managing corporations, partnerships and joint ventures which is certainly not the business of bottling soft drinks, subdividing real estate, running a restaurant, leasing equipment, selling lumber, building houses, etc.

In *Burnet v. Clark* (supra) the taxpayer was the majority stockholder in the Bowers Southern Dredging Company, a corporation which did river and harbor improvement work. After 1917, the corporation encountered continuous financial difficulties. The taxpayer sought to carry forward as a net operating loss to apply against taxable income in 1923, $68,000 paid by him on endorsements of the company's notes and $92,000 lost on the sale of stock. The $68,000 loss had been allowed as a de-

duction in full in the year in which it had occurred. The Tax Court had found:

> "With respect to the loss of $68,000 resulting from the petitioner's endorsement of the Bowers Company note he testified that in endorsing the notes he was seeking to protect his investment *in his stock.*" (Emphasis supplied)

In denying the carry forward loss, the court found that in no sense could the corporation be regarded as a taxpayer's alter-ego and that since he was not in the business of dealing in securities, nor in that of endorsing notes, it could not be said that these losses were the result of the operation of a trade or business regularly carried on by the petitioner. Rather they "resulted from occasional transactions intended to preserve the value of his *investment* in capital shares".[3]

In neither of these cases was there any evidence, nor did the taxpayer make claim as to any activities of organizing, financing and managing enterprises.

Respondent confesses that:

> "The vital distinction between a 'trade or business' and other activities which, though not incident to a 'trade or business', are nonetheless undertaken for the purpose of profit results in a basic differentiation between *'business' activities* and *'investment' activities.*" (Br. 20) (Emphasis supplied)

He admits (Br. 30) that managing corporations may be a business and, in fact, that being a salaried officer of a corporation can constitute a business.

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[3] **Burnet v. Clark**, 287 U.S. 410, 415; 77 L. Ed. 397, 399.

Respondent admits that lending money can constitute a business. (Br. 30).

He further admits (Br. 12, Ftn. 4) that renting properties can constitute a business.

As has been shown, Petitioner, A. J. Whipple, was over a long period of years, including the years 1952 and 1953, very extensively engaged in all three of these activities as well as other *"business" activities*, and paid tax on ordinary income received from them in the total amount of $94,478.71 as follows:

	1952	1953
Salaries	$29,400.00	$33,450.00
Interest	2,285.35	1,747.59
Rent	15,570.58	12,025.19
Totals	$47,255.93	$47,222.78

Petitioner also paid tax on $56,376.28 ordinary income received from partnership and joint ventures that he had organized as follows:

In 1952	$29,198.37
In 1953	$27,177.91
Total	$56,376.28

The combination of his business activities rewarded him with ordinary income totaling $150,854.99 during those two years. An integral part of Petitioner's business activities was the financing of the corporations, partnerships and joint ventures which he had formed.

Petitioner testified to following a practice of lending them money temporarily as needed and then taking it out

to be used again (R. 92). He said this practice continued over a period of ten years (R. 92) and was still being followed in 1953 when, in addition to $52,500 lent to Mission Orange (R. 63), he lent $25,000 to $30,000 to another corporation. (R. 121) He collected interest from six corporations in 1952 and from three in 1953. (R. 29) The loans to Mission Orange Bottling Co., Inc., one of the many enterprises he had organized and was managing and to whom he was renting, totalled $131,778.26 during the years 1951-1953, and he was repaid $74,803.16, leaving the net in question of $56,975.10. Therefore, these loans were incurred as a part of his over-all business. To hold that a loss suffered from the becoming worthless of a loan made to one of these enterprises was not suffered in the course of his engaging in a trade or business, would be to apply a sterile and rigid approach that is not contemplated by the statute.

As can be seen from the evidence, as soon as Petitioner sold out his interests to Strickland, he immediately began organizing a lumber company, bought land in two spots to subdivide, and formed a construction partnership, two construction corporations (Tr. 95-96) and a rental equipment corporation (R. 101). He was the moving and dominant person in all these. The very names of the companies were an indication of this.[4] He began a rental business (R. 103), lent money to these and other corporations and partnerships (R. 99) including a club over a restaurant he had bought (R. 104-5) and organized a bottling corporation (R. 114), a soft drinks distributorship cor-

[4] **A. J. Whipple Construction Co.; Whipple Lumber Co.; Dozier Whipple Construction Co.; Whipple Construction Co., Inc.; Whipple Equipment Co.** (R. 99).

poration (R. 112), and a vending machine business (R. 114) and helped promote oil deals. (R. 65)

The great bulk of the salaries of $29,400 in 1952 and $33,450 in 1953, plus the partnership income of $29,198.37 in 1952 and $27,177.91 in 1953 received by Petitioner were not for the conduct of the actual businesses in which the corporations and partnerships were engaged, but for managing them. He certainly didn't nail any boards, serve any steaks to customers in his restaurant or cap any bottles. In fact, he was not actively engaged in the day to day operation of any of his corporations unless its problems demanded some special concentrated attention, except as it involved matters of policy, of finance, coördination or coöperation with some of his other enterprises.[5]

He wouldn't have had time to have to be actively engaged in the business activities of bottling drinks in Lubbock, subdividing real estate in Angleton, supervising the construction of houses in Pasadena, overseeing the dis-

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[5] The distinction between these is shown by the following testimony of Mr. Barnhart, the Mission Dry representative (R. 57):

"Q. On these occasions that you met Mr. Whipple in Lubbock, Texas, what did you discuss with Mr. Whipple?

A. Well I discussed the business operation of the business with him.

Q. And did you discuss anything about the affairs and manner of handling the business?

A. Yes, sir.

Q. Are they the type discussions that you would have with the manager of a business?

A. No, sir. It was not from just—if you are referring to a resident manager or—

Q. I mean an overall general manager.

A. Yes.

Q. You had, I take it, several occasions to talk with Mr. Whipple; is that correct?

A. Yes, sir."

patching of trucks from the lumber yard in Houston, distributing soft drinks in Amarillo, greeting customers in Cousin's Restaurant, or checking the oil lease records in Washington and Lee Counties.

The final strawman the Respondent set up was that of a taxpayer's organizing, financing and managing a single corporation, saying:

> "* * * In short, if the present taxpayer's activities are confined to a single corporation, then no matter how extensive and continuous these activities may be they would not, under *Dalton* and *Clark*, constitute a separate business of 'organizing, managing, and financing.' Indeed, we are aware of no decision holding that such activities, when undertaken with respect to a single corporation, and with the sole purpose of enhancing the taxpayer's interest as stockholder of that corporation qualify as a 'trade or business.'"

This again is a supposition that has no harmony with reality and no applicability to what really was the nature of Whipple's enterprises. If he wanted to, how would one get all of the varied types of business in which he was interested in one corporation?

Furthermore, and even more important, to assume that Petitioner, himself, *could* have done so, had he wanted to, is to ignore an important aspect of his business of organizing, financing, managing and equipping corporations—that of interesting other persons in going into various businesses with him. Mr. Finley, the Mission Orange manager, would hardly have fitted into the construction business, nor is there any evidence Knostman and Webster (R. 45) were interested in investing in a restaurant. Being a partner in

constructing houses does not mean you are interested in the oil business. Certainly, Mr. Head was not interested in investing in what he characterized as "that tiger out in Lubbock". (R. 66).

Respondent's statement:

> "Indeed, whether a taxpayer conducts all phases of his operations through a single large corporation, or, instead, embodies each phase or enterprise in a distinct corporate entity, is largely a matter of choice, the difference frequently amounting to little more than a matter of bookkeeping."

shows a lack of understanding of business and the problems and demands of business management.

We have shown the very good reasons why all these many different business activities carried on in many different localities with many different people were conducted in many different corporations, partnerships and joint ventures, and hence it was not simply "a matter of choice" like a choice of color of a necktie, as the Respondent would imply, or as he said "frequently amounting to little more than a matter of bookkeeping."

The matter of bookkeeping, which he belittles, takes active and constant management to see that there are sufficient funds in the various enterprises at all times to pay the bills and keep up their credit and yet have no unnecessary amounts remaining idle in any one enterprise.

What was recognized by the Court in *Foss v. Commissioner* (1 Cir.), 75 F. 2d 326, 35-1 U.S.T.C. para. 9091 (1935), and has been the basis of the long line of cases that have followed it since, is that, in order to organize,

arrange for and keep in touch with the financing of, coördinate the various activities of, and make the general policy decisions for a group of enterprises, as in the *Whipple* case varying from a retail lumber yard, to a restaurant, to various phases of a soft drinks enterprise in Lubbock and Amarillo, rental properties, promotion of oil deals, subdivision of real estate in Pasadena, Angleton and Bellaire, construction of houses in different locations, managing an equipment rental corporation and other activities, would necessarily take such extensive time, thought and efforts of the taxpayer, completely separate from the actual business operations of each of the enterprises themselves, as to constitute a business in itself, which does not exist in the case of the single corporation. This is the basis of the decisions of the cases of multiple corporations.

CONCLUSION

In his original brief, Petitioner traced in detail the interpretations of the Congressional intent by the courts, and the Treasury Department, to show that the restrictive interpretation put upon Section 23(k) by the lower courts in this case was not that intended by Congress. In doing this numerous cases were cited to show how the law stood when the comprehensive Internal Revenue Code of 1954 was passed re-enacting the statute as it had been, and thus confirming the interpretation of the courts as of that date.

These cases were analyzed in detail to show the status of the law existing at the time of the enactment of the Internal Revenue Code of 1954, the continuance of the

rule by a substantial number of cases and what a radical departure from this long line of cases the decision of the lower courts was in requiring that the corporations must be organized for sale. The Respondent admits in his brief that such a requirement is completely without practical application. (Br. 28).

Furthermore, the Respondent admits that in order to establish even the somewhat broader rule that he proposes[1] that the *Foss* case, and many of the other long-standing cases[2] cited by the Petitioner to show that the rule of the lower courts was wrong must be overruled. Petitioner does not agree that these cases should be overruled, since they have received the approval of Congress and are based on sound tax principles.

Petitioner points out in his brief that the facts of his case take it far beyond most of those in which business bad debt treatment has been allowed. For instance, the Petitioner was not just in the business of organizing, managing and financing corporations carrying on one particular type of business activity as in the *Campbell*[3] case, and, furthermore, he was carrying on business activities involving leasing to these corporations, an activity not present in that case. On the other hand, in some of the other cases there was no evidence that the taxpayer carried on any such

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[1] "Organizing, financing and managing one or more corporations does not constitute a 'trade or business' of a taxpayer-stockholder if he engages in these activities without compensation, looking for his reward solely to an increase in the value of his corporation's stock." (Br. 23).

[2] See footnote 4 on page 12 of Respondent's brief.

[3] **Campbell v. Commissioner,** 11 T.C. 510, Acq. 1949-1 C.B. 1

extensive activity of organizing and managing corporations as did the Petitioner. In very few, in fact, was the element of renting to the corporations present. Many of the other cases where *business* activities have been recognized involved far less financing, not only as to amounts, but regularity of history over a long period of years, as does the case of Petitioner.

Few of them show the strong evidence of the income received for managerial services that Petitioner's does.

Actually, disregarding all the strawmen, if Respondent's brief is carefully analyzed, it boils down to the real statement of the rule as being the basic differentiation between *business* activities and *investment* activities. (Br. 20)

As shown earlier in the brief in detail, Petitioner engaged in extensive activities of organizing, financing, managing and leasing to corporations, partnerships and joint ventures primarily for the purpose of creating entities to supply him with ordinary income in the form of salaries, interest, rents and partnership profits. There is no contention, at all, that he engaged in these activities for the purpose of enhancing the value of his corporate stock to sell it, and the evidence shows that his dividend income was relatively negligible.

Respondent tries to dismiss these extensive, regular and varied business activities resulting in $150,854.99 of ordinary income in a period of two years, as opposed to $3,300 of investment income, as a "scattergun claim". Respondent's use of such a superficial term cannot be because he fails to understand the applicability of the facts of Petitioner's case to the rule which he, himself, expounds; it

must be that he has no way of refuting the fact that Petitioner falls under it.

It is respectfully submitted that the abundant facts of Petitioner's case show that his activities were those of a businessman and not those of a mere investor, so that the only way the decision of the lower courts could be affirmed is to adopt a rule which would throw Petitioner Whipple and all similar enterprising and progressive small businessmen in the same category as the taxpayer in the *Higgins*[4] case, who never participated in any business or managerial activities but, who made his investments from a French chateau.

PRAYER

Petitioner prays that the judgments of the Tax Court and the Court of Appeals for the Fifth Circuit be reversed and rendered by this Honorable Court.

The case should be reversed because the Courts below applied an incorrect legal standard to the activities of Petitioner, A. J. Whipple, in determining that the $56,975.10 bad debt loss he sustained was not incurred in his "trade or business" as used in Section 23(k)(4) IRC 1939.

This case should be rendered and judgment entered allowing Petitioner a business bad debt deduction in the amount of $56,975.10, as prayed for in Petitioner's Petition for Redetermination of the Deficiency because the record clearly shows that the $56,975.10 bad debt of Mission Orange Bottling Co. of Lubbock, Inc., was incurred in

[4] **Higgins v. Commissioner**, 312 U.S. 212, 85 L. Ed. 783

Petitioner's trade or business within the meaning of Section 23(k) of the Internal Revenue Code of 1939.

Respectfully submitted,

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PROOF OF SERVICE

It is hereby certified that five copies of the above and foregoing Reply Brief of Petitioner were served on Archibald Cox, Solicitor General, Department of Justice, Washington 25, D. C., by depositing the same in the United States Post Office at Houston, Texas, air mail postage prepaid on this_____day of March, 1963.

_____
Counsel for Petitioners

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

A. J. WHIPPLE and MILDRED WHIPPLE,

Petitioners,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING

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SUBJECT INDEX

	PAGE
INTRODUCTION	1
GROUNDS FOR REHEARING	2
CRUX OF THE DECISION	2
POINTS:	
I. Union dues have uniformly been held by the Internal Revenue Service to be deductible	3
II. It was nowhere intimated in the Government's Briefs and hence Petitioners' counsel was not alerted to the fact that this Court would be asked to rule in a manner directly contrary to specific statutory provisions	3
III. Applicable material on legislative history is not available in Texas	8
IV. Government's failure to cite applicable statutory provisions	9
V. Present decision is contrary to statute	10
VI. Problems on remand not considered	11
VII. Conclusion	12

AUTHORITIES CITED

Cases

	PAGE
Campbell, Vincent C., 11 TC 510, *Acquiescence*, 1949-1 CB 1	12
DuPont v. Deputy, 289 U. S. 685	4
Higgins v. Commissioner, 312 U. S. 212	4
Kales v. Commissioner, 101 F2d 35	8
Motch, Edwin R., Jr., 11 TC 777, rev'd. 180 F2d 859	9, 10
Sperry v. The Florida Bar, U. S. , 5/27/63	4, 8
United States v. Gilmore, 372 U. S. 39	4, 8, 12
von Echt, Alice P. Bachofen, 21 BTA 702 rev'd. 11/9/32, 1 P-H BTA Memo Dec. ¶ 32,254	7, 8

Statutes

1954 Internal Revenue Code, § 7701(a)(26)	2, 4, 10
1939 Internal Revenue Code, § 23(a)	8
§ 48(d)	2, 4
1942 Revenue Act, § 121(e)	4, 5

Other Authorities

TREATIES	
United Kingdom-United States Income Tax Treaty (60 Stat. 1377)	11, 12
INTERNAL REVENUE RULINGS	
I.T. 4012, 1950-1 CB 33	10
"*Your Income Tax*" 1961 Edition p. 45	3
COMMITTEE REPORTS	
Senate Report No. 558, 73rd Cong., 2d Sess. (Finance)	11

PAGE

CONGRESSIONAL HEARINGS

Finance Committee, 1934 Rev. Act, H.R. 7835, 73rd Cong., 2d Sess., March 6, 1934 3, 5, 7

TEXTS AND LAW REVIEWS

Seidman's Legislative History of Federal Income Tax Law, 1861-1938 5

Seidman's Legislative History of Federal Income and Excess Profits Tax Laws, 1953-1939 6

Dean Erwin N. Griswold, 52 Harv. L. R. 718 6

No. 305

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

A. J. WHIPPLE and MILDRED WHIPPLE, *Petitioners,*

against

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR REHEARING

Introduction

The above-captioned case was argued March 26 and March 27, 1963, by Mr. Charles Dillingham of Houston, Texas, for the Petitioners, and The Solicitor General for the Respondent.[1]

The case was decided by an opinion handed down on May 13, 1963, written by Mr. Justice WHITE; Mr. Justice DOUGLAS dissented without opinion; there were no other expressions of views of other members of this Court.[2]

The basic issue is whether a bad debt was properly deducted as a business bad debt as Petitioners argued; or whether it was deductible only as a non-business bad debt as Respondent argued successfully. If the Petitioners had prevailed, the bad debt would have been fully deductible from ordinary income; since the Respondent prevailed, the bad debt has been held to be deductible as a short-term capital loss (deductible only against capital gains).

[1] The *dramatis personae* are mentioned since, as it will be shown, there is some relevancy.

[2] Again, this fact is mentioned as relevant. Specific comments from Associate Justices Black, Goldberg and Stewart could have been reasonably expected in the light of the matters hereinafter set forth.

The importance of the issue to the Government can be assumed from the fact that The Solicitor General personally argued the Government's case.

Grounds for Rehearing

(1) The Respondent failed to cite a statutory provision (1954 Internal Revenue Code Section 7701(a) (26)) which makes the Court's opinion untenable and at variance with statutory law.

(2) The Respondent induced the Court to assume, contrary to the fact that the 1942 amendments approved this Court's prior holdings; the historical fact is the reverse, the amendment was retroactive back to March 1, 1913.

(3) Important historical material on Legislative History has only recently been discovered and should be considered.

(4) Important legislative material is available to Respondent but not to Petitioners and warrants this Court's consideration of methods to equalize this disparity in litigating capabilities.

(5) The Court's opinion may lead to the disallowance of Union Dues which have been allowed as deductions for 50 years.

Crux of the Decision

Perhaps the very heart of Mr. Justice WHITE's opinion is summarized in the following sentence:

> "If full-time service to one corporation does not alone amount to a trade or business, which it does not, it is difficult to understand how the same service to many corporations would suffice."

We think that we will present a case where this Court has not had its attention properly called to the applicable

statutory provisions and the legislative history which *induced* Congress[3] to enact the provisions which it did and that this Court will come to a very different conclusion after the matters hereinafter set forth are reviewed.

I.

Union dues have uniformly been held by the Internal Revenue Service to be deductible.[4]

There is no statutory authority. The administrative practice for 50 years has been based upon the fact that an employee is *ipso facto* engaged in *his own* trade or business whether or not it can be said that he is, by the same token, engaged in his employer's trade or business. Certainly at least one member of the present Court will concede that there are employers who, rightly or wrongly, would say that the payment of Union Dues by their employees advances the employer's trade or business not at all, in fact the very reverse.

Hence we think it is fair to assume that had Mr. Justice GOLDBERG been advised by The Solicitor General that painting, with the broad brush which he offered to the Court, would result in at least jeopardizing, if not furnishing direct support for reversing, the long established administrative practice of allowing deductions for Union Dues, he would have specifically concurred. More likely, violently dissented.

II.

It was nowhere intimated in the Government's Briefs and hence Petitioners' counsel was not alerted to the fact that this Court would be asked to rule in a manner directly contrary to specific statutory provisions.

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[3] Finance Committee Hearings, 1934 Revenue Act, quoted *infra*.

[4] "Your Income Tax," 1961 Edition page 45. An annual official publication of the Internal Revenue Service.

Section 7701 (a)(26) of the 1954 Internal Revenue Code is a re-enactment of Section 48(d) of the 1939 Code, *both of which*, read as follows:

> "TRADE OR BUSINESS.—The term 'trade or business': includes the performance of the functions of a public office."

This provision was written into the Revenue Act of 1934 as a result of the Internal Revenue Bureau's campaign to disallow the hire of clerks and telephone calls made by United States Senators. The Court's action not only in its May 13th decision in the instant case but also in the decision upon which that opinion was based, the February 18, 1963, opinion in *United States v. Gilmore*, 372 U. S. 39, could very well cause a resurgence of the pre-1934 campaign

The importance of legislative history has only recently been emphasized by this Court's decision of May 27, 1963, in *Sperry v. State of Florida ex rel. The Florida Bar*, U. S. .

We will demonstrate that the Court's action on May 13, 1963, in the instant case is "inconsistent with the assumptions upon which Congress has acted for over a [half] century." *Sperry* case, *supra*.

The first erroneous assumption which this Court was induced to make in both the instant case and the *Gilmore* case was that the 1942 amendments to Section 23(a) of the 1939 Code were a ratification of this Court's prior decisions in *DuPont*, *Higgins* and the other cases cited in the Court's opinion.

Nothing could be further from the historical fact.

The allowance of non-trade or non-business expense deductions inserted in the 1939 Code by Section 121 of the Revenue Act of 1942 was *retroactive back to March 1, 1913.*

Section 121(e) of the 1942 Revenue Act, which has not been cited by the Court (and perhaps overlooked), reads as follows:

> "(e) **Retroactive amendment to prior revenue acts.** For the purposes of the Revenue Act of 1938 *or any prior revenue Act*, the amendments made to the Internal Revenue Code by this section shall be effective as if they were a part of such revenue Act on the date of its enactment." [Emphasis ours.]

The Legislative History, only recently (and then only partly), has been made available to counsel for the Petitioners for very understandable reasons which will be stated.

Since Mr. Justice BLACK was, in 1934, sitting as one of the United States Senators from the State of Alabama, we can refer to his probable personal recollection of the Internal Revenue Bureau's campaign to disallow the expenses of United States Senators (paid beyond Congressional allotments) for Clerks' hire and telephone expenses. The Internal Revenue Bureau took the position that these were campaign expenses and not deductible under familiar doctrine. This was in the early months of 1934 when the Finance Committee was conducting hearings on what was to become the Revenue Act of 1934, the Bill then pending being H. R. 7835, 73rd Congress, 2d Session. The Hearings of March 6, 1934, before the Finance Committee have only recently been located and under circumstances remarkable enough to warrant their being brought to the attention of this Court.

The Hearings as originally reprinted were marked "Confidential." We will comment later on whether taxpayers generally and your Petitioners particularly should be denied the opportunity of presenting information on Legislative History which is readily available to the Respondent, the Internal Revenue Service, the Treasury Department and Justice Department.

When Mr. J. S. Seidman published his "Seidman's Legislative History of Federal Income Tax Law 1861-1938," he knew of these Hearings but was told that they were still classified as Confidential. When his book was reviewed by

Dean Erwin N. Griswold, 52 Harvard Law Review 718, Mr. Seidman was criticized for not including all relevant material.[5]

Upon this critical review coming to Mr. Seidman's attention, he wrote Dean Griswold and said that he refrained from publishing classified material lest he be criticized. Whereupon Dean Griswold wrote that, although these and other Congressional Hearings were classified, they had since been declassified.

Hence, when Mr. Seidman brought out his later work (Seidman's Legislative History of Federal Income and Excess Profits Tax Laws 1953-1939), he stated at page xv:

> "At the end of each Code section provision in this edition there is a reference table to the pages of related legislative history in the previous editions. Following this in some instances is a caption 'Additional Material.' This treats primarily with material that was classified by Congress as confidential when the previous editions were published but are now no longer restricted."

Mr. Seidman made avaible to one of your writers the Hearings of March 6, 1934, which will be quoted in part. However, when the same writer attempted to verify the "declassification" of these Hearings, he was told by the Legislative History Sections of both the Internal Revenue Service and Justice Department that "declassification" could not be verified; the applicable volume does not appear in the Library of Congress or at least is not readily locat-

[5] Dean Griswold said: "It should be pointed out, however, that the present volume is not complete. Not only does it omit entirely the material on estate, gift, and miscellaneous taxes, but there is much material bearing on the construction of the income tax sections to which it makes no reference. Thus, the important statement of Dr. Adams on the Revenue Act of 1921 does not appear here. No reference is made to the Gregg statement on the 1924 Act. *There are numerous other omissions*, enough so that it will apparently be impossible to rely on the present compilation as much more than a digest or partial index. The only place where the complete sources may now be found is in the compilations which have been made by Carlton Fox, Esq., of the Department of Justice. The final story on the legislative history of the Revenue Acts will not be told until Mr. Fox's compilations can be made more readily available." [Emphasis ours.]

able. The return of the inquiries was that the statement of Dr. Rosewell Magill was still classified "Confidential." In the light of this information, although we had read his remarks, we refrain from directly quoting him. However, there is no indication that the remarks of the Senators were classified and hence we will set forth, in the footnote, Senator Clark's comment[6] at page 30.

The amendment proposed was actually adopted by the Finance Committee but apparently was withdrawn on the renewed representation that it was unnecessary because the proposed amendment *was already the existing law and the established administrative practice.*

Being the administrative practice, Union Dues are obviously deductible as a business expense. The May 13th decision and the sentance from the opinion quoted at the outset indicates that there will be a new campaign to disallow the expenses of earning taxable income which everyone thought was put to rest by the 1942 amendment retroactive to March 1, 1913.

There is another facet of the early days of the pre-1942 campaign to disallow expenses of earning taxable income that should be called to this Court's attention. It first broke the surface on December 15, 1930, when the Board of Tax Appeals released the opinion in *Alice P. Bachofen von Echt,* 21 BTA 702. A bare majority of the Board held that attorneys' fees of preserving a life tenant's interest were not deductible. A stinging dissent was written by Member Sumner L. Trussell, concurred in by Members Lansdon, Phillips, Arundell, Van Fossan and Seawell, holding that the expenses should be deductible and if not deductible, the expenses were certainly capital expendi-

[6] "Senator Clark: Mr. Chairman, it seems to me that the point raised by Senator McAdoo might well be cleared up. Dr. Magill says that the Department has construed 'trade or business' to include 'professions' or 'vocations' or activity; but it seems to me the word 'profession' or 'vocation' ought to be inserted there. In other words, certainly there is no more reason why a lawyer, a doctor, or anybody else should have the right to make a deduction for the necessary expenses of carrying on their professions and vocations, than in the case of a man engaged as a plumber, or anything else."

tures[7] and not personal non-deductible non-capitalizable items. The taxpayer then applied for a rehearing and on November 9, 1932, the Board reversed itself and held the expenses deductible,[8]

III.

At this point it seems appropriate to make clear that Texas taxpayers represented by Texas attorneys (until the filing of this Petition) have been denied access to materials available in larger and older centers such as New York and Boston and the libraries therein. In part this can be traced to a heretofore unpublicized policy of classifying Hearings before the Congressional Committees on matters of everyday interest such as Internal Revenue campaigns. If it were wartime or the hearings involved the National Security, of course, it would be a different story.

Your Petitioners urge that The Solicitor General be directed to file a Response setting forth statutory or practical justification for this secrecy and setting forth the Legislative History on this subject as enthusiastically as it was produced in *Sperry* v. *The Florida Bar*, *supra*.

The Hearings before the Senate Finance Committee were attended by a large group of Treasury officials. The regular reporter took stenographic minutes. The minutes were transcribed at public expense. The Hearings were

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[7] Now we have an explanation why the 1942 amendment to Section 23(a) was made retroactive: to prevent the Internal Revenue Bureau from being "whipsawed." The 1942 amendment made many expenses deductible which the Treasury Department had, successfully, ruled non-deductible. Taxpayers could, justifiably, claim that their cost basis should be increased although deductions were allowed. The retroactive provision of the 1942 amendment served to disallow addition to basis to those other taxpayers whose deductions were disallowed. A former member of this Court might have observed that "this is keeping the promise to the ear but breaking it to the hope."

[8] The reversal can only be found in 1 Prentice-Hall BTA Memo Decisions ¶ 32,254. This work was only published in 1945 when it became known that these important BTA Memorandum Decisions were not otherwise available to the Bar and the Courts. Hence it is understandable that the Second Circuit cited the published *von Echt* decision in its *Kales* case, 101 F2d 35, in 1939 since the unpublished reversal in 1932 was not called to its attention. This little facet of the Respondent's campaign to disallow the expenses of earning taxable income illustrates the very many erroneous assumptions which this Court was induced to make both in the instant case and in *Gilmore*, *supra*, and which now should be reconsidered and reviewed.

printed at public expense. This particular Hearing involves something very crucial to taxpayers generally. Except for the caveat "CONFIDENTIAL" on the cover, they are the ordinary pamphlet copies of Hearings that have been freely distributed since very early times. Mr. Seidman has asked us to emphasize that he has never been in Government Service in Treasury or Justice and he acquired his copy through a source not now identifiable but certainly not surreptitious. If the conversations took place and everyone was sworn to secrecy and no one talked, there would be no report to make.

Obviously this is a matter of great public interest for the protection of taxpayers from executive and administrative abuse. But for the fortunate finding of these minutes, this Court might be placed in a very untenable light before the Congressional Committees.

We submit that the Court should reject any notion that it will turn its back on this vital disclosure of administrative practice and the attempts at Congressional correction.

IV.

Next, we would point out that the Government's failure to refer to Section 48(d) of the 1939 Internal Revenue Code (and its 1954 re-enactment) is not new. It occurred in 1950 in the Sixth Circuit in a manner which should excite the interest of Mr. Justice STEWART if it has not previously been brought to his attention. In *Edwin R. Motch, Jr.*, 11 TC 777 the Tax Court had allowed the travelling expenses incurred by the taxpayer, an Army officer, in operating his Cadillac to advance his official duties. On appeal to the Sixth Circuit, the Commissioner talked about everything else but Section 48(d), painting with no broader brush than was used in *Gilmore* and in the instant case, and the Commissioner convinced Circuit Judges ALLEN, MARTIN and MCALLISTER that the Army officer's Cadillac expenses were not deductible (180 F2d 859).

The only trouble was: the brush was so broad it also disallowed the bus and subway carfares of Internal Revenue Agents.

The solution? Disregard the Sixth Circuit decision! This the Internal Revenue Service did in *IT-4012*, published in the Internal Revenue Bulletin of June 12, 1950, page 2, 1950-1 CB 33:

> "In view of the foregoing, the Bureau will not follow the decision in *Commissioner* v. *Edwin R. Motch, Jr., et ux., supra*, as a precedent insofar as it holds that traveling expenses in excess of per diem allowances, incurred by military and civilian officers and employees of the United States in the performance of their official duties, are not deductible under section 23(a)(1)(A) of the Internal Revenue Code."

While both the Internal Revenue Service and Justice Department frequently (and understandably) refuse to follow decisions *adverse* to their contentions, *Motch* is the only case that we know of where the Government has refused to follow an applicable Court decision *in its favor!*

Of course, this Court knows that Internal Revenue matters are an intensely practical subject and the true history must be learned at the taxpayer-Internal Revenue Agent level. An Internal Revenue Agent's explanation of why the Service refused to follow a decision in its favor reflects no credit on three very distinguished jurists.

V.

Now we can return to the crucial sentence of the decision in this case which bears repeating:

> "If full-time service to one corporation does not alone amount to a trade or business, which it does not, it is difficult to understand how the same service to many corporations would suffice."

Obviously this Court will give due deference to the positive command of what is now Section 7701(a)(26), quoted

in full, *supra*, page 4. In *IT-4012, supra*, the Internal Revenue Service, said:

> "In Senate Report No. 558, 73rd Cong., 2d Sess., page 29, (2 CB 1939-1, 586 at 608) submitted to accompany the Revenue Bill of 1934, the Commmittee on Finance stated that Section 48(d) was *declaratory of existing law.*" [Emphasis ours]

This could only be true if "existing law" was that *employment of any kind* was, in and of itself, the carrying on of *the employee's* trade or business and hence it was logical to make no distinction between private employment and public employment even to the point of high Public Office. We submit that the Court has unwittingly been placed in a dilemma which should be resolved by reargument and a revision of both the May 13, 1963, opinion and its direction for remand.

VI.

At the conclusion of Mr. Justice WHITE's opinion, the case is remanded to the Tax Court to take proof as to whether the taxpayers, having been held not to be engaged in business as to Mr. Whipple's employment, are engaged in business by virtue of ownership and operation of rental real property.

This invites the perpetuation of the insupportable premise that the owner of investments (or an employee rendering services) is not engaged in business while an investor in real estate, no matter how "passive," is still obviously "engaged in a trade or business."

The answer is not that simple. The best illustration is the Income Tax Treaty between the United Kingdom and the United States (60 Stat. 1377). Of course, it makes a great difference in the taxation of United States income to a United Kingdom resident whether that United Kingdom resident (an alien non-resident as to United States) is

"engaged in a trade or business." Article IX of the United Kingdom-United States Income Tax Treaty solves the dilemma most effectively. It gives the non-resident alien (United Kingdom resident) *the election* to say whether or not he is "engaged in business" in the United States. Thus in Article IX (1) of that Treaty, after holding that the mere ownership of real property is not engaging in a trade or business the subparagraph concludes:

> "Provided that any such resident may elect for any taxable year to be subject to United States tax as if such resident were engaged in trade or business in the United States."

VII.

While the Court specifically overrules the case of *Vincent C. Campbell*, 11 TC 510, (footnote 10) the Court obviously failed to recognize the important dislocation in the administrative level since the *Campbell* case was acquiesced by the Internal Revenue Service in 1949 (1949-1 CB 1).

The opinion of May 13th should be recalled. The case reconsidered in the light of Legislative History not previously available in Texas. Since much of the opinion in the instant case is grounded on what we have demonstrated as the uncertain footings of *United States v. Gilmore, supra*, we respectfully submit that the Court, *sua sponte*, should recall its mandate in No. 21 and restore that case for reargument along with the reargument of the instant case. *United States v. Ohio Power Co., 353 U. S. 98.*

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 58 of the Rules of this Court.

EARL Q. KULLMAN,
Counsel for Petitioners.

CERTIFICATE OF SERVICE

I hereby certify that three copies of the foregoing Petition have been duly served by mail upon The Solicitor General, counsel for Respondent.

EARL Q. KULLMAN,
Counsel for Petitioners.